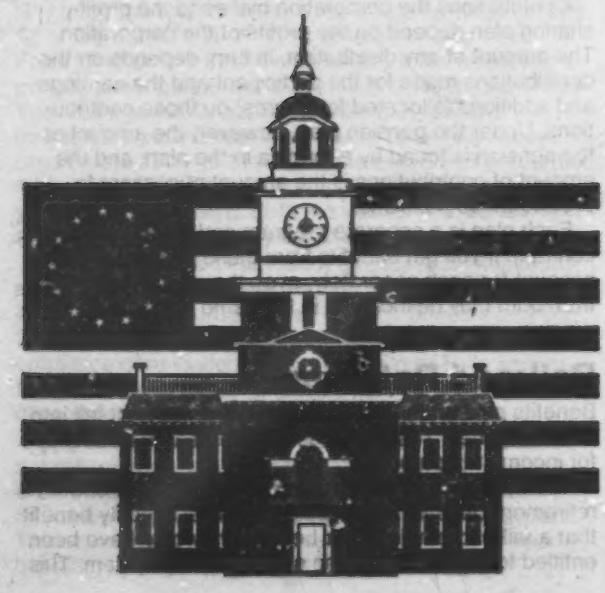
575/990

Department of the Treasury
Internal Revenue Service
Catalog Number 15142B

Publication 575

Pension and Annuity Income
(Including Simplified General Rule)

For use in preparing
1990 Returns



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Important Reminder

Change of address. If you change your mailing address, be sure to notify the Internal Revenue Service using Form 8822, *Change of Address.* Mail it to the Internal Revenue Service Center for your old address (addresses for the Service Centers are on the back of the form). If you are changing both your home and business addresses, you should complete two separate forms.

Introduction

This publication explains how to report pension and annuity income on your federal income tax return. It also covers the special tax treatment of lump-sum distributions from pension, stock bonus, or profit-sharing plans, and of rollovers from qualified employer plans.

If you are retired from the federal government (either regular or disability retirement) or are the survivor or beneficiary of a deceased employee or retiree, get Publication 721, *Tax Guide to U.S. Civil Service Retirement Benefits.*

In explaining how to figure the taxable and nontaxable parts of annuity payments you receive, this publication covers only the Simplified General Rule. You can use the Simplified General Rule only if:

1) Your annuity starting date is after July 1, 1986,
2) The annuity payments are from a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity,
3) The annuity payments are either for your life or for your life and that of your beneficiary, ***and***
4) At the time the payments began, either you were under age 75 or you were entitled to fewer than 5 years of guaranteed payments.

A ***"qualified employee plan"*** is an employer's stock bonus, pension, or profit-sharing plan that is for the exclusive benefit of employees or their beneficiaries. This plan must meet Internal Revenue Code requirements. A ***"qualified employee annuity"*** is a retirement annuity purchased by an employer for an employee under a plan that meets these requirements. A ***"tax-sheltered annuity"*** is a special annuity contract purchased for an employee of a public school or tax-exempt organization.

If your annuity starting date is after July 1, 1986, but your annuity does not meet all of the other conditions listed above, you must use the nonsimplified General Rule. Also, you must use that rule if your annuity starting date was before July 2, 1986, and you were not allowed

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to recover the nontaxable part of the annuity within the first three years under the Three-Year Rule.

If you must use the nonsimplified General Rule, you should get Publication 939, *Pension General Rule (Nonsimplified Method)*. That publication gives you the information, including actuarial tables, that you need to figure the tax treatment of your payments.

If, after reading this publication and Publication 939 (if applicable) you find that you are still unable to figure the taxable part of your pension or annuity, the IRS will do it for you. This service costs $50. For information on this service, see *Requesting a Ruling on Taxation of Annuity*, in Publication 939.

Free Publications and Forms

If you need information on a subject not covered in this publication, you may check our other free publications. To order publications and forms, call our toll-free telephone number 1-800-TAX-FORM (1-800-829-3676) or write the IRS Forms Distribution Center for your area as shown in your income tax package.

Some major related topics and the publications that cover them are listed below.

Disability retirement. If you are retired on disability, get Publication 525, *Taxable and Nontaxable Income.*

Tax-sheltered annuity programs. For rules on these programs, get Publication 571, *Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations.*

Individual Retirement Arrangements (IRAs). If you get payments from an individual retirement account, annuity, or endowment contract or from individual retirement bonds, they should be reported on lines 16a and 16b, Form 1040, or lines 10a and 10b, Form 1040A. Get Publication 590, *Individual Retirement Arrangements (IRAs).*

Self-employed retirement plans (H.R. 10 or Keogh plans). Some of the rules in this publication apply to the benefits you receive from a Keogh plan. However, get Publication 560, *Retirement Plans for the Self-Employed,* for more information.

Life insurance payments. If you received life insurance payments because of someone's death and the payments came from insurance unconnected with the person's job, get Publication 525.

Tax credit. If you get an annuity or pension, you may qualify for a special tax credit. Get Publication 524, *Credit for the Elderly or the Disabled.*

General Information

Some of the terms used in this publication are defined in the following paragraphs.

A pension is generally a series of payments made to you after you retire from work. Pension payments are made regularly and are for past services with an employer.

An annuity is a series of payments under a contract. The contract can be bought by you alone or with the help of your employer. Annuity payments are made regularly for a period of more than one full year.

Particular types of pensions and annuities include:

1) **Fixed period annuities.** You receive definite amounts at regular intervals for a definite length of time.
2) **Annuities for a single life.** You receive definite amounts at regular intervals for life. The payments end at death.
3) **Joint and survivor annuities.** The first annuitant receives a definite amount at regular intervals for life, and after he or she dies, a second annuitant receives a definite amount at regular intervals for life. The amount paid to the second annuitant may or may not differ from the amount paid to the first annuitant.
4) **Variable annuities.** You receive payments that may vary in amount for a definite length of time or for life. The amounts you receive may depend upon such variables as profits earned by the pension or annuity funds or cost-of-living indexes.
5) **Disability pensions.** You receive payments because you retired on disability and, at the time of your retirement, you were permanently and totally disabled. You may be able to take the credit for the elderly or the disabled. Get Publication 524.

More than one program. You may get employee plan benefits from more than one program under a single trust or plan of your employer. If you participate in more than one program, you may have to treat each as a separate contract, depending upon the facts in each case. Also, you may be considered to have received more than one pension or annuity. Your former employer or the administrator of the plan should be able to tell you if you have more than one pension or annuity contract.

Example. Your employer, a corporation, set up a noncontributory ***profit-sharing plan*** for its employees providing that the amount held in the account of each participant would be paid at the time of that participant's retirement. It also set up a contributory defined benefit ***pension plan*** for its employees providing for the payment of a lifetime pension to each participant after retirement.

Contributions the corporation makes to the profit-sharing plan depend on the profits of the corporation. The amount of any distribution, in turn, depends on the contributions made for the participant and the earnings and additions (allocated forfeitures) on those contributions. Under the pension plan, however, the amount of the pension is found by a formula in the plan, and the amount of contributions is the amount necessary to provide those pensions.

Each plan is a separate program and a separate contract. If you get benefits from these plans, you must account for each separately, even though the benefits from both may be included in the same check.

Railroad Retirement

Benefits paid under the Railroad Retirement Act fall into two categories. These categories are treated differently for income tax purposes.

The **first category** is the amount of tier 1 railroad retirement benefits that equals the social security benefit that a railroad employee or beneficiary would have been entitled to receive under the social security system. This

part of the tier 1 benefit is called the "social security equivalent benefit" (SSEB) and is treated for tax purposes like social security benefits. It is shown on Form RRB–1099, *Statement for Recipients of Payments by the Railroad Retirement Board.*

The second category contains the rest of the tier 1 benefits, called the "non-social security equivalent benefit" (non-SSEB), and any tier 2 benefits, vested dual benefits, and supplemental annuity benefits. This category of benefits, shown on Form RRB–W–2P, *Statement for Recipients of Annuities or Pensions by the Railroad Retirement Board,* is treated as an amount received from a qualified employer plan. This allows for the tax-free recovery of employee contributions from the tier 2 benefits and the part of the tier 1 benefits that exceeds the SSEB. Vested dual benefits and supplemental annuity benefits are fully taxable.

The employee contributions are the taxes that were withheld from the railroad employee's pay which exceeded the amount of taxes that would have been withheld had the earnings been covered under the social security system.

Form RRB–W–2P. If the General Rule applies, it has been considered in boxes 3, 5, and 9 of Form RRB–W–2P. If you want to use the Simplified General Rule, you must make your own computation. Your results may vary from the amounts shown on the Form RRB–W–2P. The information needed for the Simplified General Rule computation is shown in box 4, Employee Contributions, box 14, Contributory Amount Paid (the tier 2 and non-SSEB part of the tier 1 benefits paid during the year), and box 15, Number of Monthly Payments (made during the year), of Form RRB–W–2P. If an asterisk (*) is shown in box 15, it means that the number of monthly payments cannot be accurately figured and you should contact the U.S. Railroad Retirement Board.

The Form RRB–W–2P you receive from the Railroad Retirement Board will show separately what was paid to you in the second category benefits. These benefits may consist of the non-SSEB part of tier 1 benefits and tier 2 benefits (box 9); taxable vested dual benefits (box 10); and taxable supplemental annuity benefits (box 11). Generally the total of these three amounts shown in box 12 of the Form RRB–W–2P is entered on line 17 of Form 1040 or line 11 of Form 1040A. If the employee's annuity starting date was before July 2, 1986, the Three-Year Rule generally applied. Under that rule, the employee's contribution would have been fully recovered before 1990. In that case, the non-SSEB part of tier 1 benefits and the tier 2 benefits paid in 1990 and later years are fully taxable. Both the vested dual benefit and supplemental annuity payments are fully taxable.

Under the Three-Year Rule if employee contributions are fully recovered before the end of 1990, the total amount of any non-SSEB part of tier 1 benefits and tier 2 benefits paid in 1990 will exceed any unrecovered employee contributions. If the Three-Year Rule applies to your benefits, only the taxable part of the total benefits you receive in 1990 will be included in box 9.

The taxable amounts shown on Form RRB–W–2P do not reflect any special rules, such as the death benefit exclusion, capital gains or special averaging treatment for lump-sum payments, and rules for tax-free rollovers. To determine if any of these rules might apply to your benefits, see the discussions about them later.

Social security equivalent benefit (SSEB) part of tier 1 benefits. Use the worksheet found on page 13 of your Form 1040 income tax return instructions or page 29 of your Form 1040A instructions to figure if any of the SSEB part of your tier 1 benefits is subject to tax. The taxable part of these benefits is reported on line 21b of Form 1040 or line 13b of Form 1040A and is shown separately from any other railroad retirement benefits included on line 17 of Form 1040 or line 11 of Form 1040A. For more information on your SSEB part of tier 1 benefits, see your Form RRB–1099, *Statement for Recipients of Payments by the Railroad Retirement Board,* and Publication 915, *Social Security Benefits and Equivalent Railroad Retirement Benefits.*

Repayment of benefits. Special rules may apply if in 1990 you repaid any of the non-SSEB part of tier 1 benefits, tier 2 benefits, vested dual benefits, or supplemental annuity benefits that you had previously received. The treatment that applies depends on the years to which the repayment applies, and whether you had included the benefits that you repaid in your gross income for those years.

At the time the Railroad Retirement Board notified you about an overpayment, you were told the periods to which the overpayment and any repayment applied. If you no longer have this information, you can request it by writing to: U.S. Railroad Retirement Board, Attn: BRC—TAX—IAS, 844 N. Rush Street, Chicago, IL 60611. The amount of your repayment in 1990 is shown in box 13 of Form RRB–W–2P.

If your repayment applies to benefits you received during 1990, you can reduce the total amount of taxable benefits by the amount of the repayment that applies to the taxable part of the benefits. Include on line 17a of Form 1040 or line 11a of Form 1040A your total gross taxable benefits, shown in box 12 of Form RRB–W–2P. Include on line 17b of Form 1040 or line 11b of Form 1040A the taxable amount (the total gross taxable amount minus the amount of the repayment that applies to the taxable part of the repaid 1990 benefits).

If your repayment applies to benefits you received in a prior year and you did not include the benefits in gross income, the repayment is not deductible and does not reduce your 1990 taxable benefits. You should include on line 17b of Form 1040 or line 11b of Form 1040A the total gross taxable amount shown in box 12 of Form RRB–W–2P.

If your repayment applies to benefits you received in a prior year and were required to include in income, you may be entitled to an itemized deduction on Schedule A (Form 1040). (You cannot take this deduction if you file Form 1040A. You must file Form 1040.) The amount of the deduction is limited to the amount of the repaid benefits you included in income for the prior year. This deduction is subject to the 2% floor on miscellaneous itemized deductions. However, if you included the benefits in income because the requirement to do so was apparent (rather than actual), you could have received the benefits under a "claim of right." In that case, you may be able to figure your tax under a special rule discussed next.

You can figure your tax under a special rule if:

1) You included the benefits in your gross income for a prior tax year because you believed that you had an unrestricted right to the benefits,

2) You are entitled to a deduction for 1990 because you determined after the close of the prior tax year that you did not have an unrestricted right to the benefits, and

3) You repaid more than $3,000.

If the above conditions apply, figure your tax two ways:

1) Figure your tax for 1990 claiming an itemized deduction.

2) Figure your tax for 1990 without the deduction, and reduce this tax by the amount your tax in the prior year was increased because you included in income the amount you later repaid.

Your tax is either the amount in (1) or (2), whichever is less. (You cannot use this rule if you file Form 1040A. You must file Form 1040.) If method (1) results in less tax, deduct the repayment on Schedule A (Form 1040). This is a miscellaneous deduction but is not subject to the 2% floor on miscellaneous itemized deductions. If method (2) results in less tax, claim a credit for the tax increase in the prior year on line 61, Form 1040, and write "I.R.C. 1341" in the margin to the left of line 61. If both methods produce the same tax, take the deduction on Schedule A (Form 1040). This special rule does not apply if the repayment is due to errors, such as in arithmetic, in figuring the benefits paid to you and the facts available would have enabled you to correct the errors. This rule would also not apply if the benefits were correctly figured, giving you an unrestricted right to them, and your repayment in 1990 is because of a subsequent event other than the discovery of any restriction on that right.

Withholding Tax and Estimated Tax

Your pension or annuity is subject to federal income tax withholding unless you choose not to have tax withheld. If you choose not to have tax withheld from your pension or annuity, or if you do not have enough income tax withheld, you may have to make estimated tax payments.

Generally, your withholding tax or estimated tax, or the total of both, must cover at least 90% of your total tax for the current year. If it does not, you may owe a penalty. Get Publication 505, *Tax Withholding and Estimated Tax,* for more information.

The withholding rules generally apply to the ***taxable*** part of payments you receive from an employer pension, annuity, profit-sharing, stock bonus, or other deferred compensation plan. The rules also apply to payments from an individual retirement arrangement and a commercial annuity. For this purpose, a commercial annuity means an annuity, endowment, or life insurance contract issued by an insurance company. There will be no withholding on any part of a distribution that it is reasonable to believe will not be includible in gross income.

These withholding rules also apply to disability pension distributions received before your minimum retirement age. See *Disability Retirement* later.

Choosing no withholding. You can choose not to have tax withheld from your pension or annuity. The payer will tell you how to make the choice. This choice for no withholding remains in effect until you revoke it.

To choose exemption from withholding on pension or annuity benefits, a U.S. citizen or resident must give the payer of the benefits a residence address in the United States or its possessions. Without that address, the payer must withhold tax. For example, the payer has to withhold tax if the recipient has provided a U.S. address for a nominee, trustee, or agent to whom the benefits are delivered, but has not provided his or her own U.S. residence address.

For pension or annuity payments that are to be delivered outside the United States or its possessions, you can choose exemption from this withholding only if you certify to the payer that you are not a U.S. citizen or a U.S. resident alien or a tax-avoidance expatriate. But if you so certify, you may be subject to the 30% flat rate withholding that applies to nonresident aliens, unless you are exempt or subject to a reduced rate by treaty. For details, get Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations.*

Withholding certificate. For purposes of withholding income tax on periodic payments, your pension or annuity will be treated like wages. Periodic payments are amounts paid at regular intervals, such as weekly, monthly, or yearly, over a certain period of time, such as for 15 years or for life. You should give the payer of your pension or annuity a completed withholding certificate (Form W–4P or a similar form provided by the payer). If you do not, the payer must withhold as if you were married with three withholding allowances. You should file a new withholding certificate to change the amount of withholding.

Nonperiodic distributions. For a nonperiodic distribution (a payment other than a periodic payment) that is not a qualified total distribution, the withholding will be 10% of the distribution. For a qualified total distribution, tax will be withheld based on tables prepared by the Internal Revenue Service. The part of any loan treated as a distribution, explained later, is subject to withholding.

Qualified total distribution. In general, a qualified total distribution is a distribution that:

1) It is reasonable to believe will be made within one tax year,

2) Is made under a qualified plan, and

3) Consists of the balance to the employee's credit under the plan. (Deductible voluntary employee contributions are treated separately for this purpose.)

Estimated tax. Your estimated tax is the total of your expected income tax, self-employment tax, and certain other taxes for the year minus your expected credits and withheld tax. Generally, you must make estimated tax payments if your estimated tax is $500 or more and you estimate that the total amount of income tax to be withheld will be less than the lesser of: 1) 90% of the tax to be shown on your return, or 2) 100% of the tax shown on last year's return. For more information, get Publication 505.

Note: In figuring your withholding or estimated tax, remember that a part of your monthly ***social security or railroad retirement benefits*** may be taxable. The amount subject to tax will depend on the type of benefit received.

If you receive ***social security benefits or a tier 1 railroad retirement benefit***, the amount subject to tax will be the lesser of half the benefits received or half the excess of your combined income over the base amount.

Your ***combined income*** is your modified adjusted gross income plus half your social security or railroad retirement benefits. Your ***modified adjusted gross income*** is your adjusted gross income plus any tax-exempt interest you received or accrued plus amounts you earned in a foreign country, a U.S. possession, or Puerto Rico that are excluded from gross income.

Your ***base amount*** is $32,000 if you are filing jointly; zero if you are married filing separately and you did not live apart from your spouse during the entire tax year; and $25,000 for any other filing status.

Taxation of Periodic Payments

This section explains how the periodic payments you receive under a pension or annuity plan are taxed. Periodic payments are amounts paid at regular intervals (such as weekly, monthly, or yearly) over a certain period of time (such as for 15 years or for life). These payments are also known as ***amounts received as an annuity***. If you receive an amount from your plan that is ***not*** a periodic payment, see *Taxation of Nonperiodic Payments*, later.

In general, you can recover your cost of the pension or annuity tax free over the period you are to receive the payments. The amount you receive in each payment that is more than the part that represents your cost is taxable. The various rules for determining the part of each annuity payment that represents your cost are described in the following discussion.

Investment in the Contract (Cost)

The first step in figuring how much of your pension or annuity is taxable is to determine your cost (investment in the contract). If you use the Simplified General Rule, you simply divide your cost by the appropriate factor from the worksheet table (see *Simplified General Rule*, later) to figure the tax-free amount of each monthly annuity payment. If your annuity starting date is after 1986, your total exclusion from income over the years cannot exceed your cost. Your cost is also very important in determining your exclusion under the nonsimplified General Rule, but that rule is not covered in this publication. For information on it, get Publication 939.

Cost. In general, your cost is your net investment in the contract as of the annuity starting date (defined later). To find this amount, you must first figure the total premiums, contributions, or other amounts you paid. This includes the amounts your employer contributed if you were required to include these amounts in income. It does not include amounts you contributed for health and accident benefits and deductible voluntary employee contributions. The beneficiary of a deceased employee can also add any allowable death benefit exclusion to the cost of the contract (this is explained later).

From this total cost you subtract:

1) Any refunded premiums, rebates, dividends, or unrepaid loans (any of which were not included in your income) that you received on or before the later of the annuity starting date or the date on which you received your first payment.
2) Any additional premiums paid for double indemnity or disability benefits.
3) Any amounts you received under the contract or plan on or before the later of the dates in (1) that you did not have to include in your income.

The annuity starting date is either the first day of the first period for which you receive payment under the contract or the date upon which the obligation under the contract becomes fixed, whichever comes later.

Example. On January 1 you completed all your payments required under an annuity contract providing for monthly payments starting on August 1 for the period beginning July 1. The annuity starting date is July 1. This is the date you use in figuring your cost of the contract and selecting the appropriate factor from the table in the Simplified General Rule worksheet to figure the tax-free amount of each monthly annuity payment.

Adjustments. You also should add or subtract the following to or from your cost of the contract.

Foreign employment. If you worked abroad, there are special rules for figuring your cost. Your contributions include amounts contributed by your employer if:

1) You were required to include the amounts in your gross income at the time they were contributed, or
2) The amounts were contributed by your employer and you would not have been required to include them in your gross income under the law that applied at the time of the contribution if they had been paid directly to you at the time they were contributed.

Item (2) does not apply to amounts contributed by your employer after 1962 that would not have been includible in your gross income if they had been paid directly to you at the time of the contribution because of the exclusion for earned income from sources outside the United States. This is true unless the contributions were for services performed before 1963 under a plan existing on March 12, 1962.

Employees of tax-exempt organizations. Any amount you were required to include in gross income, either at the time the organization made contributions for you or when your rights under your tax-sheltered annuity contract became ***nonforfeitable***, should be included in your cost of the contract as if you had contributed that amount. Your rights are nonforfeitable if you cannot lose them.

Employees of states or political subdivisions. If you work for a state or political subdivision, do not include in your current gross income or your cost of the contract contributions to a qualified plan for you by that employer ***if:***

1) The contributions are designated as employee contributions paid ("picked up") by the employer, and

2) Payment by the employer is required. This means you have no option to negotiate a voluntary agreement with your employer to pay the contributions.

Death benefit exclusion. If you are the ***beneficiary*** of a deceased employee or a deceased former employee, the pension or annuity you get because of that person's death may qualify for a death benefit exclusion. This exclusion is limited to $5,000. The maximum total exclusion is $5,000 for each employee regardless of the number of employers paying death benefits or the number of beneficiaries.

Treat the amount of the death benefit exclusion as additional contributions to the plan by the employee. Add it to the cost or unrecovered cost of the annuity at the annuity starting date.

For periodic payments, the death benefit exclusion applies only to beneficiaries or the estate of a common-law employee. Beneficiaries of a sole proprietor or other self-employed individual who owned a share of either the capital or profits interest in a partnership are not allowed the $5,000 exclusion unless the distribution is from a qualified pension or annuity plan and the decedent died after 1983. After 1982, a shareholder-employee who owns more than 2% of the outstanding stock of an S corporation or more than 2% of the total combined voting power of all stock of an S corporation is treated as a partner and, therefore, for purposes of the death benefit exclusion, a self-employed individual. But see *Death benefit exclusion,* under *Special Tax Treatment,* later.

Generally, the death benefit exclusion does not apply to amounts that the employee had, immediately before death, a nonforfeitable right to receive while living. It does apply to lump-sum distributions from a qualified pension, annuity, stock bonus, or profit-sharing plan or from certain tax-sheltered annuities. If you are the survivor under a ***joint and survivor annuity,*** the exclusion only applies if:

1) The deceased had received no retirement pension or annuity payments, or
2) The deceased had received disability income payments that were not treated as pension or annuity income.

Even if the employee dies after the annuity starting date, the death benefit exclusion applies to amounts received by a beneficiary if the beneficiary is not the survivor under a joint and survivor annuity.

Example. Herb Rider's employer had a pension plan that provided that Herb and his wife, Barbara, would receive payments under a joint and survivor annuity after he retired. The plan also provided that any of his children under age 22 at the time of his death would receive annuity payments until the child married, ceased to be a student, reached age 22, or died. No reduction is made in Herb's or Barbara's annuity for these payments to their children. Herb died after he had retired and started receiving annuity payments. He left a widow and a child who was under 22 years old.

Herb's widow cannot claim the death benefit exclusion because she is the surviving annuitant under a joint and survivor annuity and Herb died after the annuity starting date.

Herb's child can claim a death benefit exclusion because the amounts paid to the child are not paid under a joint and survivor annuity, but are paid by or for his employer and are paid because of his death.

Fully Taxable Payments

The pension or annuity payments that you receive are fully taxable if you have no investment in the contract (cost) because:

1) You did not pay anything or are not considered to have paid anything for your pension or annuity, or
2) Your employer did not withhold contributions from your salary, or
3) You got back all of your contributions tax free in prior years.

Report the total amount you got on line 17b, Form 1040, or line 11b, Form 1040A. You should make no entry on line 17a, Form 1040, or line 11a, Form 1040A.

Deductible voluntary employee contributions. Distributions you receive that are based on your accumulated deductible voluntary employee contributions, which include net earnings on these contributions, are generally fully taxable in the year distributed to you and do not qualify for special 5- or 10-year averaging or long-term capital gain treatment.

Elective deferrals. If you are covered by certain kinds of retirement plans, you can choose to have part of your pay contributed by your employer to a retirement fund, rather than have it paid to you. These amounts are called "elective deferrals," because you choose (elect) to set aside the money, and tax on the money is deferred until it is distributed to you.

Elective deferrals include elective contributions to cash or deferred arrangements (known as **section 401(k) plans**), section 501(c)(18) plans, salary reduction simplified employee pension (SEP) plans, and tax-sheltered annuities provided for employees of tax-exempt organizations and public schools. However, an employer contribution to a tax-sheltered annuity is not treated as an elective deferral if it is made under a one-time choice by you as soon as you become eligible to participate in the agreement.

Because these contributions (elective deferrals) are considered to be made by your employer, you are taxed on any payments you receive from the retirement fund unless the payments are rolled over. See *Rollovers,* later. If a payment from the fund meets the requirements of a lump-sum distribution, it may qualify for special 5- or 10-year averaging, which is also discussed later.

Limits on elective deferrals. For 1990, generally, you may not defer more than a total of $7,979 for all qualified plans by which you are covered. (This limit applies without regard to community property laws.) If you defer more than $7,979, the excess is included in your gross income for 1990.

Special limit for tax-sheltered annuities. If you are covered by only one plan, and that plan is a tax-sheltered annuity, you may defer up to $9,500 each year. If you are covered by several different plans and at least one of the plans is a tax-sheltered annuity, then the basic limit ($7,979 for 1990) for all deferrals is increased

by the amount deferred in the tax-sheltered annuity that year, up to an overall total of $9,500.

If you have completed at least 15 years of service with an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches (or associated organization), the $9,500 limit is increased for each tax year. The limit is increased above $9,500 for a year by the *least* of the following:

1) $3,000, or
2) $15,000, reduced by increases to the $9,500 limit you were allowed in earlier years because you were covered by a tax-sheltered annuity, or
3) $5,000 times the number of your years of service for the organization, minus the total elective deferrals under the plan for earlier years.

Cost-of-living adjustment. For 1990, the basic limit on elective deferrals is $7,979. This limit is subject to annual increases to reflect inflation (as measured by the Consumer Price Index).

Reporting by employer. The total amount deferred for the tax year must be reported on the Form W-2, *Wage and Tax Statement,* given to you by your employer.

Treatment of excess deferrals. If the total you defer is more than the limit for the year, the excess is included in your gross income for the year. If the plan permits, you can receive the excess amount.

If only one plan is involved and it permits these distributions, you must notify the plan by the date required by the plan that an excess was deferred. (The notification must not be later than April 15 after the end of the tax year.) The plan must then pay you the amount of the excess, along with any income earned on that amount, by April 15.

If more than one plan is involved, you can have the excess paid out of any of the plans that permit these distributions. You must notify each plan by the date required by that plan of the amount to be paid from that particular plan, and the plan must then pay you that amount by April 15. (The notification must not be later than April 15 after the end of the tax year.)

Even if you take out the excess by April 15, the amount still counts as having been contributed for purposes of satisfying or not satisfying the requirements the plan must meet regarding not discriminating in favor of highly compensated employees.

If you take out the excess by April 15, it is not again included in your gross income. Any ***income*** on the excess taken out is taxable in the tax year in which it is taken out. This distribution is not subject to the additional 10% tax on distributions before age 59½.

If you take out ***part*** of the excess deferral and the income on it, the distribution is treated as made proportionately from the excess deferral and the income.

If you do not take out the excess amount, the amount included in your gross income but not distributed remains in the plan. But the excess amount is not included in your cost of the contract for purposes of figuring the taxable amount of any eventual benefits or distributions under the plan. In effect, an excess deferral left in the plan would be taxed twice, once when contributed, and then again when distributed.

Section 457 plans—deferred compensation plans of state and local governments and tax-exempt organizations. If you participate in an eligible deferred compensation plan of a state or local government or tax-exempt organization, you will not be taxed currently on your pay that is deferred under the plan. You or your beneficiary will be taxed on this deferred pay only when it is distributed or made available to either of you.

Distributions of deferred pay are not eligible for special 5- or 10-year averaging or rollover treatment, both discussed later, or the death benefit exclusion, discussed earlier. Distributions are, however, subject to the tax for not making minimum distributions, discussed later.

To find out if your plan is an eligible plan, check with your employer. However, the following are ***not*** treated as section 457 plans:

1) Bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plans,
2) Nonelective deferred compensation plans for nonemployees (independent contractors), or
3) Deferred compensation plans maintained by churches for church employees.

Limit on deferrals under section 457 plans. If you are a participant in a section 457 plan, you can generally set aside no more than ⅓ of your includible compensation, up to $7,500 each year. There is also a special catch-up limit of up to $15,000 for each of your last 3 years of service before reaching normal retirement age. Amounts you defer under the other elective deferrals discussed earlier may affect your limits under section 457 plans. Amounts you defer under section 457 plans may affect the amount you can defer in tax-sheltered annuities under the special limit discussed earlier.

Partly Taxable Payments

If you contributed to your pension or annuity and your annuity starting date is after July 1, 1986, you must use either the General Rule or, if you qualify, the Simplified General Rule to figure the taxability of your payments. If your annuity starting date was before July 2, 1986, and you did not recover your cost using the Three-Year Rule, you must use the General Rule (if you recovered your cost under the Three-Year Rule, you cannot use the General Rule or the Simplified General Rule because your payments are fully taxable).

Under either the General Rule or the Simplified General Rule, you exclude a part of each payment from your income because it is considered a return of your annuity cost.

Exclusion limited to cost. If your annuity starting date is after 1986, the total amount of annuity income that you can exclude over the years as a return of the cost cannot exceed your total cost (reduced by the value of any refund feature, if you are using the General Rule). If your annuity starting date is after July 1, 1986, any unrecovered cost at your (or the last annuitant's) death is allowed as an itemized deduction in the last tax year.

and is not subject to the 2% floor on miscellaneous itemized deductions.

Example 1. Your annuity starting date is after 1986, and you exclude $100 a month under the Simplified General Rule. Your total cost of the annuity is $12,000. Your exclusion ends when you have recovered your cost tax free, that is, after 10 years (120 months). Thereafter, your annuity payments are fully taxable.

Example 2. If, in Example 1, you had instead died (with no surviving annuitant) after the eighth year of retirement, you would have recovered tax free only $9,600 (8 × $1,200) of your investment. An itemized deduction for your unrecovered investment of $2,400 ($12,000 minus $9,600) can be taken on your final return.

Exclusion not limited to cost. If your annuity starting date was before 1987, you continue to take your monthly exclusion figured under the General Rule or the Simplified General Rule for as long as you receive your annuity. If you choose a joint and survivor annuity, your survivor continues to take the survivor's exclusion figured as of the annuity starting date. The total exclusion may be more than your investment (cost) in the contract. If your annuity starting date was after July 1, 1986, and the last annuitant dies before the total cost is recovered, the unrecovered cost is still allowed as a deduction in the last tax year.

General Rule Under the General Rule, you determine the tax-free part of each annuity payment based on the ratio of your cost of the contract to the total expected return. Expected return is the total amount you and other eligible annuitants can expect to receive under the contract. To figure it, you must use life expectancy (actuarial) tables prescribed by the IRS. The General Rule is not discussed further in this publication. Complete information on the General Rule, including the tables you need, is contained in Publication 939, *Pension General Rule (Nonsimplified Method)*.

Simplified General Rule

If you qualify to use the Simplified General Rule, you will probably find it both simpler and more beneficial than the General Rule for figuring the taxable and nontaxable parts of your annuity.

Who can use it. You may be able to use the Simplified General Rule if you are a retired employee or are the survivor, receiving a survivor annuity, of an employee who died. You can use this simpler method to figure the taxability of your pension ***only*** if:

1) Your annuity starting date is after July 1, 1986,
2) The annuity payments are for either your life, or your life and that of your beneficiary,
3) The annuity payments are from a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity, ***and***
4) At the time the payments began, either you were under age 75 or were entitled to fewer than 5 years of guaranteed payments.

How to use it. If you meet these conditions and you choose the Simplified General Rule, use the worksheet in the back of the publication to figure your taxable pension for 1990. In completing this worksheet, use your age at the birthday preceding your annuity starting date Be sure to keep the completed worksheet; it will help you figure your 1991 taxable pension.

The following example illustrates the simplified method:

Example. Bill Kirkland, age 65, began receiving retirement benefits in January 1990 under a joint and survivor annuity to be paid for the joint lives of Bill and his wife, Kathy. He had contributed $24,000 to the plan and had received no distributions before the annuity starting date. Bill is to receive a retirement benefit of $1,000 a month, and Kathy is to receive a monthly survivor benefit of $500 upon Bill's death.

Bill chooses to use the Simplified General Rule computation. He fills in the worksheet as follows:

Worksheet for Simplified General Rule

1.	Total pension received this year. Also, enter this amount on Form 1040, line 17a, or Form 1040A, line 11a		$12,000
2.	Your cost in the plan (contract) at annuity starting date, plus death benefit exclusion*		24,000
3.	Age at annuity starting date:	Enter:	
	55 and under	300	
	56–60	260	
	61–65	240	
	66–70	170	
	71 and over	120	240
4.	Divide the amount on line 2 by the number on line 3		100
5.	Multiply the amount on line 4 by the number of months for which this year's payments were made		1,200
	NOTE: If your annuity starting date is **before 1987,** subtract line 5 from line 1 and enter the result (but not less than zero) on line 9 below. Skip lines 6, 7, 8, 10, and 11.		
6.	Any amounts previously recovered tax free in years after 1986		–0–
7.	Subtract the amount on line 6 from the amount on line 2		24,000
8.	Enter the lesser of the amount on line 5 or the amount on line 7, but no more than the amount on line 1. (If this is zero, your pension is fully taxable.)		1,200
9.	**Taxable pension for year.** Subtract the amount on line 8 from the amount on line 1. Also enter this amount on Form 1040. line 17b, or Form 1040A, line 11b.		$10,800
10.	Add the amounts on lines 6 and 8		1,200
11.	Balance of cost to be recovered. Subtract the amount on line 10 from the amount on line 2		$22,800
	NOTE: If your Form W–2P shows a larger taxable amount, use the amount on line 9 instead of the amount from Form W–2P		

***Statement for death benefit exclusion**

Cost in plan (contract) ..... $ _____

Death benefit exclusion ..... _____

Total (enter on line 2 above) ..... $ _____

Signed: _____

Date: _____

KEEP FOR YOUR RECORDS

Bill's tax-free monthly amount is $100 (see line 4 of the worksheet). If he lives to collect more than 240 monthly payments, he will have to include in his gross income the full amount of any annuity payments received after 240 payments have been made.

If Bill does not live to collect 240 monthly payments and his wife, Kathy, begins to receive monthly payments, she will also exclude $100 from each monthly payment until a total of 240 payments (Bill's and hers) have been collected. If she dies before 240 payments have been made, a miscellaneous itemized deduction (not subject to the 2% floor on miscellaneous deductions) will be allowed for the unrecovered cost on her final income tax return.

Death benefit exclusion. If you are a beneficiary of a deceased employee or former employee, you may qualify for a death benefit exclusion of up to $5,000, discussed under *Investment in the Contract (Cost)*, earlier. If you choose to use the Simplified General Rule and you qualify for the death benefit exclusion, you may increase the total investment in the pension or annuity contract (on line 2 of the worksheet) by the amount of the allowable death benefit exclusion.

However, the payer of the annuity cannot add the death benefit exclusion to the cost for reporting the tax-free and taxable parts of a payment on Form W–2P. The Form W–2P taxable amount will be larger than the amount you will figure for yourself. Report on Form 1040, line 17b, or Form 1040A, line 11b, the smaller amount that you figure and attach a signed statement to the return stating that you are entitled to the death benefit exclusion in making the Simplified General Rule computation.

Example. Diane Greene, age 48, began receiving a $1,500 monthly annuity in 1990 upon the death of her husband. She received 10 payments in 1990. Her husband had contributed $25,000 to his qualified employee plan. In addition, Diane is entitled to a $5,000 death benefit exclusion for the annuity payments. She adds that amount to her husband's contributions to the plan, for a total cost in the contract of $30,000.

Diane chooses to use the Simplified General Rule. She fills out the worksheet as follows:

Worksheet for Simplified General Rule

1.	Total pension received this year. Also, enter this amount on Form 1040, line 17a, or Form 1040A, line 11a	$15,000
2.	Your cost in the plan (contract) at annuity starting date, plus death benefit exclusion*	30,000
3.	Age at annuity starting date: / Enter:	
	55 and under / 300	
	56–60 / 260	
	61–65 / 240	
	66–70 / 170	
	71 and over / 120	300
4.	Divide the amount on line 2 by the number on line 3	100
5.	Multiply the amount on line 4 by the number of months for which this year's payments were made	1,000
	NOTE: If your annuity starting date is **before 1987,** subtract line 5 from line 1 and enter the result (but not less than zero) on line 9 below. Skip lines 6, 7, 8, 10, and 11.	
6.	Any amounts previously recovered tax free in years after 1986	-0-
7.	Subtract the amount on line 6 from the amount on line 2	30,000
8.	Enter the lesser of the amount on line 5 or the amount on line 7, but no more than the amount on line 1. (If this is zero, your pension is fully taxable.)	1,000
9.	**Taxable pension for year.** Subtract the amount on line 8 from the amount on line 1. Also enter this amount on Form 1040, line 17b, or Form 1040A, line 11b.	$14,000
10.	Add the amounts on lines 6 and 8	1,000
11.	Balance of cost to be recovered. Subtract the amount on line 10 from the amount on line 2	$29,000
	NOTE: If your Form W–2P shows a larger taxable amount, use the amount on line 9 instead of the amount from Form W–2P	

***Statement for death benefit exclusion**

Cost in plan (contract)	$25,000
Death benefit exclusion	5,000
Total (enter on line 2 above)	$30,000

Signed: Diane Greene

Date: 4-10-91

KEEP FOR YOUR RECORDS

In completing Form W–2P, the payer of the annuity (the employer of Diane's husband) chooses to report the taxable part of the annuity payments using the Simplified General Rule. However, since the payer does not adjust the cost of the contract by the death benefit exclusion, the payer figures the tax-free part of each monthly payment to be $83.33, as follows:

$$\frac{\text{Total cost: } \$25{,}000}{\text{Expected payments: } 300} = \$83.33$$ (Monthly return of cost)

However, Diane had figured a $100 monthly tax-free amount (see line 4 of the worksheet). Because of this difference in the computations, the Form W–2P given by the payer to Diane will show a greater taxable amount than what she figured for herself. She should report on

line 17b of Form 1040 or line 11b of Form 1040A only the smaller taxable amount based on her own computation. She must attach a signed statement to her income tax return stating that she is entitled to the death benefit exclusion in making the Simplified General Rule computation.

Changing the method. If your annuity starting date is after July 1, 1986, you can change the way you figure your pension recovery exclusion (from the General Rule to the Simplified General Rule, or the other way around) by filing amended returns for all your tax years beginning with the year in which your annuity starting date occurred. You must use the same method for all years, unless you choose the Simplified General Rule for 1988 and later years but not for 1986 or 1987 (see the following discussion). Generally, you can make the change only within 3 years from the due date of your return for the year in which you received your first annuity payment (or, if later, within 2 years from the date the tax for that year was paid).

Annuity starting date before 1988. If your annuity starting date was before July 2, 1986, you cannot choose the Simplified General Rule at any time. If your annuity starting date is after July 1, 1986, and before January 1, 1988, you can:

1) Start to use the Simplified General Rule in 1988 without amending your 1986 or 1987 returns, or
2) Amend your 1987 (and, if applicable, your 1986) return to apply the Simplified General Rule to the annuity distributions for that year (or years).

If you choose to use the Simplified General Rule for 1988 without amending your prior returns, base it on the facts (annuity cost, age, etc.) as of the actual annuity starting date in 1986 or 1987 even though you are applying the rule to distributions beginning in 1988.

If your annuity starting date was in 1987, and you choose to apply the Simplified General Rule to your 1987 distributions, file an amended return for 1987. If you received your first annuity payment in 1986, and you choose to apply the Simplified General Rule to your 1986 and 1987 distributions, file amended returns for both 1986 and 1987. You cannot choose the Simplified General Rule for 1987 only, while applying the General Rule to 1986; you must apply the Simplified General Rule to all years beginning with the year in which your annuity starting date occurred if you choose to apply it to any of those years. See *Changing the method,* above.

Disability Retirement

If you retired on disability, you must report your disability income as ordinary income. However, you may be entitled to a credit. See *Credit for Elderly or Disabled,* later.

Disability Payments

If you retired on disability, payments you receive are taxable as ordinary income until you reach ***minimum retirement age.*** Beginning on the day after you reach minimum retirement age, your payments are treated as a retirement annuity. At that time you begin to recover your cost of the annuity under the rules discussed earlier.

Minimum retirement age is the age at which you could first receive an annuity were you not disabled.

How to report. You must report all your taxable disability payments on line 7, Form 1040 or Form 1040A, until you reach minimum retirement age.

Credit for Elderly or Disabled

You may be able to take the credit for the elderly or the disabled if:

1) You were age 65 or older at the end of the tax year, or
2) You were under age 65 at the end of the tax year and you meet all of the following tests:
   a) You are retired on permanent and total disability, or if you retired before 1977, you were permanently and totally disabled on January 1, 1976, or January 1, 1977,
   b) You received taxable disability income, and
   c) You did not reach ***mandatory retirement age*** before the beginning of the tax year.

You are retired on permanent and total disability if you were permanently and totally disabled when you retired, are still permanently and totally disabled, and receive disability income because of the disability. If you retired on disability before 1977, you did not have to be permanently and totally disabled at the time you retired, provided you were permanently and totally disabled on January 1, 1976, or January 1, 1977.

Mandatory retirement age is the age set by your employer at which you must retire.

Permanently and totally disabled. You are permanently and totally disabled if you cannot engage in ***any*** substantial gainful activity because of your physical or mental condition. The substantial gainful activity is not limited to your job activity performed before you retired, or a similar activity. A physician must determine that your condition is expected to result in death or has lasted, or can be expected to last, for a continuous period of at least 12 months. For further information on what is substantial gainful activity, get Publication 524, *Credit for the Elderly or the Disabled.*

Physician's statement. If you are under 65 and retired on permanent and total disability, have your doctor complete the *Physician's Statement* in Part II of Schedule R (Form 1040). If you filed a physician's statement for the same disability with your return for 1983 or an earlier year or you filed a statement for tax years after 1983 and your physician checked Box B on the statement, check the box in Part II. You do not have to file another physician's statement this year. If you have not filed a physician's statement in a previous year, or you filed a statement for tax years after 1983 and your physician checked Box A, you must have your physician complete a statement.

Figuring the credit. If you want the Internal Revenue Service to figure your tax and credits, including the credit for the elderly or for the disabled, see the instructions for Form 1040 or Form 1040A.

For complete information on this credit, get Publication 524.

Taxation of Nonperiodic Payments

This section of the publication explains how any ***nonperiodic*** payments you receive under a pension or annuity plan are taxed. Nonperiodic payments are also known as ***amounts not received as an annuity.*** They include all payments other than periodic payments. How much of these payments is subject to tax depends on when they are made in relation to the annuity starting date, and, if they are made ***before*** the annuity starting date, the type of contract or transaction from which they result.

Distributions of current earnings (dividends) on your investment in an annuity, endowment, or life insurance contract are generally taxable as amounts not received as an annuity. However, do not include these distributions in your income to the extent the insurer uses them to pay premiums or some other consideration for the contract.

Once you determine how much of a nonperiodic distribution is subject to tax, you can then apply the rules relating to tax-free rollovers and special averaging or capital gain treatment of amounts that qualify as lump-sum distributions. These rules are discussed later.

Nonperiodic distribution on or after annuity starting date. If you receive a nonperiodic payment from your annuity contract ***on or after the annuity starting date,*** you generally must include all of the payment in gross income. For example, a cost-of-living increase in your pension after the annuity starting date is an amount not received as an annuity, and as such is fully taxable.

Reduction in subsequent payments. If the annuity payments you are to receive thereafter are reduced because you received the nonperiodic distribution, you can exclude part of the distribution payment from gross income. The part you can exclude is equal to your cost in the contract reduced by any tax-free amounts you previously received under the contract, multiplied by a fraction. The numerator (top part of the fraction) is the reduction in each annuity payment because of the nonperiodic distribution, and the denominator (bottom part of the fraction) is the full unreduced amount of each annuity payment originally provided for.

Distribution in full discharge of contract. If you receive an amount on or after the annuity starting date that fully satisfies the payer's obligation under the contract (as a refund of what you paid for the contract or upon the complete surrender, redemption, or maturity of the contract), you include the amount in gross income only to the extent that it exceeds your remaining cost of the contract.

Distribution before annuity starting date. If you receive a nonperiodic distribution ***before*** the annuity starting date from a ***qualified retirement plan,*** you generally must allocate the amount received between your cost of the contract and the income from the contract. You exclude from your gross income the part of the amount received that you allocate to your cost. You include the remainder of the amount received in your gross income. (There are some exceptions to this allocation rule. See *Allocation not required,* later.)

For this purpose, a qualified retirement plan includes a:

- Qualified employee retirement plan (or annuity contract purchased by such a plan),
- Qualified annuity plan,
- Tax-sheltered annuity, and
- Individual retirement arrangement (IRA).

To figure the excludable amount of a distribution before the annuity starting date from such a qualified retirement plan, use the following formula:

$$\text{Amount received} \times \frac{\text{Cost of contract}}{\text{Account balance}} = \text{Excludable amount}$$

For this purpose, your account balance includes only amounts to which you have a nonforfeitable right (a right that cannot be taken away).

Under a defined contribution plan, your contributions (and income allocable to them) may be treated as a separate contract for figuring the taxable part of any distribution. A defined contribution plan is a plan in which you have an individual account and in which your benefits are based only on the amount contributed to the account and the income, expenses, etc., allocated to the account.

Example. Before she had a right to an annuity, Ann Blake received $50,000 from her retirement plan. She had $10,000 invested (cost) in the plan, and her account balance was $100,000. She can exclude $5,000 of the $50,000 received, figured as follows:

$$\$50{,}000 \times \frac{\$10{,}000}{\$100{,}000} = \$5{,}000$$

Plans that permitted withdrawal of employee contributions. If your pension plan, as of May 5, 1986, permitted the withdrawal of any of your employee contributions (not employer contributions under a salary reduction agreement) before your separation from service, the allocation described above applies only to a limited extent. It applies only to the extent that nonperiodic distributions received before the annuity starting date (increased by amounts previously received under the contract after 1986) exceed your cost of the contract as of December 31, 1986. You can receive nonperiodic distributions, up to your cost of the contract on that date, tax free as a recovery of cost at any time before the annuity starting date.

If you are covered by a plan maintained by a state government, which on May 5, 1986, permitted withdrawal of employee contributions other than as an annuity, the above rule for limited allocation applies to you even though you withdraw your contributions after separating from service. In applying the rule, you treat any amount you receive (other than as an annuity) before or with the first annuity payment as an amount received before the annuity starting date.

Plans other than qualified retirement plans. If you receive a nonperiodic distribution before the annuity starting date from a plan (such as a commercial annuity) ***other than*** a qualified retirement plan, you generally

also must make an allocation in determining the taxable part of the distribution.

However, this allocation formula differs from the one described earlier. In this situation, you must ***include*** in gross income an amount of the nonperiodic distribution equal to the excess (if any) of:

1) The cash value of the contract (figured without considering any surrender charge) immediately before you receive the amount, over
2) Your investment in the contract at that time.

You can exclude from your income the remainder, if any, of the nonperiodic distribution as a recovery of cost.

Allocation not required. Certain nonperiodic distributions received before the annuity starting date are ***not*** subject to the allocation rules discussed earlier. If you receive such a distribution, you include the amount in gross income only to the extent that it exceeds your cost of the contract. If you receive an amount that is includible in gross income, you may be able to roll it over tax free, or apply special averaging or capital gain treatment to it as explained later.

Distributions for which allocation between income and investment is not required include the following:

- **Distributions in full discharge of a contract** that you receive as a refund of what you paid for the contract or that you receive on the complete surrender, redemption, or maturity of the contract.
- **Distributions from life insurance or endowment contracts** (other than modified endowment contracts, as defined in Internal Revenue Code section 7702A) that are not received as an annuity under the contracts.
- **Distributions under contracts entered into before August 14, 1982,** to the extent that they are allocable to cost before August 14, 1982.

Loans Treated as Distributions

If you borrow money from an employer's qualified pension or annuity plan, tax-sheltered annuity program, or government plan or from a contract purchased under any of these plans, you may have to treat the loan as a nonperiodic distribution unless it comes under the exception explained below. This means that you will have to include all or part of the amount borrowed in your income under the rules discussed earlier. The treatment is the same if you pledge or assign any part of your interest in any of these plans (or agree to do this). Further, if you renegotiate, extend, renew, or revise a loan, you may have to treat the outstanding balance of the loan as a distribution on the date of such transaction.

Exception for loans repayable in 5 years or home loans. If by the terms of the loan described above you must repay it within 5 years (and you do not extend it by renegotiation or other means) or you use it to buy a main home, only part of the loan might be treated as a distribution. You treat the loan as a distribution only to the extent that it, when added to the outstanding balances of all your other loans from all plans of your employer and certain related employers, exceeds the lesser of:

1) $50,000, or
2) Half the present value (but not less than $10,000) of your nonforfeitable accrued benefit under the plan, determined without regard to any accumulated deductible employee contributions.

You must reduce the $50,000 amount in (1) above by the excess (if any) of your highest outstanding balance of loans from the plan during the 1-year period ending on the day ***before*** the date on which you took out the loan over the outstanding balance of your loans from the plan on the date on which you took out the loan.

A home loan is a loan to buy a dwelling to be used within a reasonable time as your main home.

Level payments required. The exception for loans repayable within 5 years and for home loans applies only if the loan terms require substantially level payments made at least quarterly over the life of the loan.

Denial of interest deduction. Even if you do not have to treat all or part of a loan as a distribution because of the exception for loans repayable in 5 years (or for home loans), you still may not deduct any of the interest on the loan during the period that:

1) The loan is secured by amounts from elective deferrals under a qualified cash or deferred arrangement (section 401(k) plan) or a tax-sheltered annuity, or
2) You are a key employee as defined in Internal Revenue Code section 416(i).

Related employers and related plans. For the loans-treated-as-distributions rules, you must treat separate employers' plans as plans of a single employer if they are so treated under other qualified retirement plan rules because the employers are considered to be related. You must treat all plans of a single employer as one plan.

Transfers of Annuity Contracts

If you transfer without full and adequate consideration an annuity contract issued after April 22, 1987, you are treated as receiving an amount as a nonperiodic distribution equal to the excess of:

1) The cash surrender value of the contract at the time of transfer, over
2) The cost of the contract at that time.

This rule does not apply to transfers between spouses or transfers incident to a divorce.

Lump-Sum Distributions

A lump-sum distribution must be paid within one tax year. It is the distribution or payment of an employee's entire balance from all of the employer's qualified pension plans, stock bonus plans, or qualified profit-sharing plans. (Deductible voluntary employee contributions and certain amounts forfeited are excluded from the employee's balance.)

The distribution must be paid:

1) Because of the employee's death,

2) After the employee reaches age 59½,
3) Because the employee separates from service, or
4) After a self-employed individual becomes totally and permanently disabled.

The separation-from-service condition in (3) does not apply to a self-employed individual.

How to treat the distribution. If you receive a lump-sum distribution from a qualified retirement plan, you may have various options on how to treat the distribution. You can:

1) Roll over all or part of the distribution. No tax is currently due on the part rolled over. See *Rollovers*, later.
2) Report the entire taxable part of the distribution as ordinary income on your tax return.
3) Report the part of the distribution from pre-1974 participation as a capital gain and the amount from post-1973 participation as ordinary income (if you qualify).
4) Use the *Special 5- or 10-Year Averaging Method*, discussed later, to figure the tax on the ordinary income portion of the distribution (for post-1973 participation), reporting the capital gain part (for pre-1974 participation) on Form 4972, Part II, or on Schedule D (Form 1040) (if you qualify).
5) Use the special 5- or 10-year averaging method to figure the tax on the total taxable amount by treating the capital gain part as ordinary income (if you qualify).

These various options are explained in the following discussions.

Special Tax Treatment

If you get a lump-sum distribution from a qualified retirement plan, you may be able to get special tax treatment on the distribution. Generally, the part of the distribution from active participation in a plan before 1974 may qualify for long-term capital gain treatment. The part from participation after 1973 is taxed as ordinary income. This ordinary income part may be taxed under the special 5- or 10-year averaging method, discussed later.

If the distribution is not a total distribution (a payment of the entire balance to the employee's credit), no part qualifies for capital gain treatment. Also, the special 5- or 10-year averaging rules, discussed later, do not apply. In that case, you should report the total amount you got on line 17a, Form 1040, or line 11a, Form 1040A, and the taxable part on line 17b, Form 1040, or line 11b, Form 1040A.

A distribution from a tax-sheltered annuity does not qualify for either kind of special tax treatment.

Cost recovered tax free. You may recover your *cost* in the lump sum tax free. Also, you may be entitled to special tax treatment for the remaining part of the distribution.

In general, your cost consists of:

1) The employee's total nondeductible contributions to the plan;
2) The total of the employee's taxable costs of life insurance under the plan;
3) Any employer contributions that were taxable to the employee; and
4) Repayments of loans that were taxable to the employee.

You must reduce this cost by amounts previously distributed to you tax free.

Long-term capital gain treatment. If the employee for whom the lump-sum distribution is paid reached age 50 before 1986 (was born before 1936), you can choose to treat a portion of the taxable part of a lump-sum distribution as a long-term capital gain taxable at 20%. This treatment applies to the portion you receive for the employee's participation in the plan before 1974. A recipient can make only one choice with regard to an employee. Use Form 4972, *Tax on Lump-Sum Distributions*, to make this choice.

Regardless of the employee's age, you can report part of the capital gain on Schedule D (Form 1040), if you do not make the choice in the preceding paragraph. The part that is eligible for Schedule D treatment is being phased out, and the treatment will be unavailable after 1991. For distributions in 1990, you may treat 50% of the pre-1974 portion as capital gain and in 1991, 25%. The 20% rate in the preceding paragraph does not apply in this situation.

Special averaging method. If the employee for whom the lump-sum distribution is paid reached age 50 before 1986 (was born before 1936), you can choose a special averaging method to figure the tax on the ordinary income portion of the distribution. (This includes the capital gain portion of the distribution if you do not choose capital gain treatment for it.) To qualify, you must use special averaging on all lump-sum distributions received in the tax year for that employee.

To use the special averaging method for a distribution you receive for your own participation in the retirement plan, you must have been a participant in the plan for 5 or more years. You can only make one lifetime election to use this method for lump-sum distributions with regard to any employee.

If you choose the special averaging method, you figure your tax using Form 4972.

Deductible voluntary employee contributions. A distribution you receive based on deductible voluntary employee contributions plus any net earnings on these contributions does not qualify as a lump-sum distribution. A deductible voluntary employee contribution is:

1) A contribution the employee made to a qualified employer plan or a government plan that allows such contributions,
2) A contribution that the employee did not designate as nondeductible, and
3) A contribution that was not mandatory.

Reemployment. If there is the possibility that a separated employee's vested percentage in his or her retirement benefit may increase if he or she is rehired by the former employer, this possibility does not prevent the distribution from qualifying as a lump-sum distribution. However, if a rehired employee's vested percentage in the benefits previously subject to special lump-sum treatment increases due to services performed after reemployment, the taxes saved by applying lump-

sum treatment must be recaptured as provided by Treasury regulations.

The total taxable amount of a lump-sum distribution is the part that is the employer's contribution and income earned on the account. The nontaxable parts of the distribution are the employee's contribution (if previously included in his or her income) and the net unrealized appreciation in employer's securities distributed, together with the death benefit exclusion, if applicable. The employee's contribution should be reduced by any amounts previously distributed to the employee that did not have to be included in gross income because they were a return of the employee's contributions.

Figuring the capital gain and ordinary income parts. Generally, figure the capital gain and ordinary income parts of a lump-sum distribution by using the following formulas:

$$\text{Total taxable amount} \times \frac{\text{Months of active participation before 1974}}{\text{Total months of active participation}} = \text{Capital Gain}$$

$$\text{Total taxable amount} \times \frac{\text{Months of active participation after 1973}}{\text{Total months of active participation}} = \text{Ordinary Income}$$

In figuring the months of active participation before 1974, any part of a calendar year in which the employee was an active participant under the plan is counted as 12 months. For active participation after 1973, any part of a calendar month in which you were an active participant under the plan is counted as 1 month.

The capital gain and ordinary income parts should be shown on Form 1099–R, *Statement for Recipients of Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.*, or other statement given to you by the payer of the distribution. However, if these amounts are not shown, ask the payer for them.

If you do not use the special 5– or 10–year averaging method and do not make either capital gain election, you report the total taxable amount (shown in box 2 of Form 1099–R) of the lump-sum distribution on line 17b of Form 1040 or line 11b of Form 1040A.

Allocating death benefit exclusion. If you can take the death benefit exclusion and make the capital gain election (pre–1974 participation), you must allocate the death benefit exclusion between the ordinary income and capital gain parts of the distribution. Follow the Form 4972 instructions for Part II, line 1, to figure the allocation. Enter the balance of the death benefit exclusion on line 2 of Part III or IV if you elect 5– or 10–year averaging.

Allocating federal estate tax. If any federal estate tax (discussed under *Survivors and Beneficiaries*, later) is attributable to the lump-sum distribution and you make the capital gain election, you must allocate the estate tax between the ordinary income and capital gain parts of the distribution. Follow the Form 4972 instructions for Part II, line 1, to figure the allocation and your entry on line 11 of Part III or IV. If you do not make the capital gain election, enter on line 11 the federal estate tax attributable to both the capital gain and the ordinary income parts of the lump-sum distribution. For information on how to figure the estate tax attributable to the lump-sum distribution, get Publication 448, *Federal Estate and Gift Taxes*.

Losses. You can claim a loss on your return if you receive, ***entirely in cash,*** a lump-sum distribution from a qualified plan and the distribution is less than the total of the employee's contributions to the plan.

To claim the loss, you must itemize deductions on Schedule A (Form 1040). Show the loss as a miscellaneous deduction (subject to the 2%-of-adjusted-gross-income limit). The amount that you may claim as a loss is the difference between the employee's total contributions and the amount of the distribution.

Death benefit exclusion. The death benefit exclusion of up to $5,000 applies to lump-sum distributions paid on behalf of common-law employees, and, in certain cases, retirees. The death benefit exclusion also applies to lump-sum distributions paid on behalf of any self-employed individual from a qualified trust or annuity plan. See *Death benefit exclusion* under *Investment in the Contract (Cost)*, earlier.

Shareholder-employees of S corporations. Shareholder-employees who own more than 2% of the outstanding stock of an S corporation or more than 2% of the total combined voting power of all stock of an S corporation are treated as partners. They are, therefore, treated as self-employed individuals for the death benefit exclusion. The death benefit exclusion applies to a lump-sum distribution paid from a qualified trust or annuity plan on behalf of these shareholder-employees.

Transfer of lump-sum distributions. You may be able to transfer (roll over) all or part of the distribution from your employer's plan tax free to an individual retirement arrangement (IRA) or to another qualified plan. The most you can transfer tax free is the difference between your cost (see *Cost recovered tax free*, earlier) and the amount of the distribution. See *Rollovers*, later.

Distributions of employer securities. If you get a lump-sum distribution that includes securities in the employer's company—that is, stocks, bonds, registered debentures, or debentures with interest coupons—these securities may have increased in value while they were in the trust. This increase is called "net unrealized appreciation." You are not taxed on the net unrealized appreciation at the time the securities are distributed to you. This treatment does not apply to a distribution of deductible voluntary employee contributions (defined earlier).

You can choose to be taxed on this amount. Make this choice on the tax return on which the distribution is required to be included.

When you later sell or exchange these securities, any gain is taxed as a ***long-term*** capital gain up to the amount of the net unrealized appreciation regardless of how long you held the securities. Any part of the gain that is more than the net unrealized appreciation at the time of distribution is a long-term or short-term capital

gain depending on how long you held the securities from the date they were distributed to you.

If all you receive are worthless securities, you can claim a loss of the employee's total contributions to the plan. To do so, you must itemize your deductions on Schedule A (Form 1040) and claim the loss as a miscellaneous deduction (subject to the 2%-of-adjusted-gross-income limit).

You cannot claim a loss if all you receive is stock that has a fair market value that is less than the amount of the employee's total contributions to the plan. You can claim a loss when you sell or exchange the stock if the amount you get for it is less than the employee's contributions allocated to the shares of stock sold.

Distribution of U.S. Savings Bonds. When you cash a U.S. Savings Bond, the bank or other payer that redeems it must give you a Form 1099–INT, *Statement for Recipients of Interest Income*, if the interest part of the payment you receive is $10 or more. Your Form 1099–INT should show the difference between the amount received and the amount paid for the bond. However, if you received the bond in a taxable distribution from a retirement plan, the difference is generally shown on Form 1099–R, *Statement for Recipients of Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.* The distribution (including accrued interest on the bond at the time of distribution from the plan) is reported on your tax return as income. When you cash the bond, the interest shown on Form 1099–INT will not be reduced by the bond's accrued interest that had already been reported on your return as part of the taxable distribution. Therefore, your Form 1099–INT will show more interest than you are required to include in your income.

You must make an adjustment on your tax return to report the correct amount of interest. See Publication 550, *Investment Income and Expenses*, for information about the correct reporting of this interest.

Special 5– or 10–Year Averaging Method

If the employee for whom you receive a ***lump-sum distribution,*** defined earlier, reached age 50 before 1986 (was born before 1936), you can figure your tax on the distribution by using either 5–year averaging or 10–year averaging. This tax is in addition to the regular tax figured on your other income.

If you choose the 5–year averaging method, the tax is computed on Form 4972 using 1990 tax rates. If you choose the 10–year averaging method, the tax is computed on Form 4972 using the special 1986 tax rates shown in the Form 4972 Instructions. Do not use the tax rates shown in the 1986 tax forms instructions.

Although called averaging methods, the 5–year and 10–year methods are special formulas for figuring the tax on the lump-sum distribution only for the year of receipt. You pay the tax only once. You do not pay the tax over the next 5 or 10 years.

Ordinary income–capital gain. You can choose to treat the ordinary income part (box 2 minus box 3, Form 1099–R) under the special method. You also can treat the capital gain part of the distribution as ordinary income under the special method if you ***do not*** choose capital gain treatment for that part.

If you do not use the special method for the ordinary income part, report the entire ordinary income part on line 17b, Form 1040. Whether or not you use the special method for the ordinary income part will not affect the treatment of the capital gain part of the distribution.

Who can use the method. Any individual, estate, or trust receiving a lump-sum distribution with respect to an employee who reached age 50 before 1986 (was born before 1936), can use the special method. In the case of distributions to individuals, estates, or a single trust, the individual, estate, or trust must make the choice for that portion of the distribution received. If the distribution is made to two or more trusts, the employee or the personal representative of a deceased employee must make the decision.

The special 5– or 10–year averaging method cannot be used for any amount distributed from a plan to an employee who has not been a participant in that plan for at least 5 full tax years before the tax year in which the distribution is made. This rule does not apply to distributions to beneficiaries made because the employee died.

If you choose the special method, you must use the same method (either 5–year or 10–year averaging) for all distributions received in that tax year for that employee. You cannot make more than one choice for distributions for any employee.

Alternate payee under qualified domestic relations order. If you receive a distribution as an alternate payee under a qualified domestic relations order (discussed later under *Rollovers),* you can choose the special averaging method for it provided it would be treated as a lump-sum distribution if received by your spouse or former spouse (the employee). However, for this purpose, the balance to your credit does not include any amount payable to the employee.

Complete Form 4972 and attach it to your Form 1040 return if you want to use the special method. If you received more than one lump-sum distribution for an employee during the year, you must add them together in using the special method.

If you and your spouse are filing a joint return and you both have received a lump-sum distribution, each of you should complete a separate Form 4972. Then add the separate taxes from the Forms 4972 and enter the total on line 39, Form 1040.

Time for choosing. You must decide to use the special method before the end of the time, including extensions, for making a claim for credit or refund of taxes. This is usually 3 years from the date the return was filed or 2 years from the date the tax was paid, whichever is later. (Returns filed before April 15 are considered filed on April 15.)

Changing your mind. You can change your mind and decide not to use the special method within the time period just discussed. If you change your mind, file Form 1040X, *Amended U.S. Individual Income Tax Return,* with a statement saying you do not want to use the special method. You must pay any additional taxes due to the change with the Form 1040X.

Distributions for more than one year. If you received one or more lump-sum distributions or received an annuity contract in 1985 or 1986 and used the special 5–year or 10–year averaging method for them, add these distributions to the 1990 distribution if you choose the special

averaging method for it. This will result in the tax being figured as if all the distributions were received in one tax year. Any special 5– or 10–year averaging tax on earlier distributions is subtracted from this tax. See Form 4972, General Instructions, Tax on Prior Year Lump-Sum Distributions. These rules apply only if you used the special averaging method for the earlier year.

More than one recipient. The special averaging method can be used by one or all of the recipients of a lump-sum distribution. See Form 4972, Line-by-Line instructions, Multiple Recipients of a Lump-Sum Distribution.

Community property laws are disregarded for the special 5– or 10–year averaging method.

Distributions not eligible for averaging. The special 5– or 10–year averaging method does not apply to any of the following:

1) U.S. Retirement Plan Bonds distributed with a lump sum.
2) Any distribution made before the employee was a participant in the plan for 5 tax years before the tax year of the distribution, unless it was made because the employee died.
3) The capital gain part of a lump-sum distribution if the recipient chooses to treat the amount attributable to pre-1974 participation as capital gain.
4) The current actuarial value of an annuity contract included in a lump-sum distribution.
5) Distributions to a 5% owner that are subject to a penalty because the distributions exceed the benefits provided under the plan formula.
6) A distribution from any other pension plan of your employer if you rolled over after 1978 a distribution from that employer's money purchase pension plan into an individual retirement arrangement (IRA) or another qualified plan.
7) A distribution from an individual retirement arrangement (IRA).
8) A distribution from a qualified employer plan if the recipient elected after July 18, 1984, to roll over tax free the redemption proceeds of bonds provided under a qualified bond purchase plan.
9) A distribution from a qualified employer plan when the employee or the employee's surviving spouse received a partial distribution from the same plan (or another plan of the employer required to be combined with that plan for the lump-sum distribution rules) if the proceeds of the previous distribution were rolled over tax free to an individual retirement arrangement (IRA).
10) A corrective distribution of excess deferrals, excess contributions, or excess aggregate contributions.
11) The Federal Civil Service lump-sum credit payment.
12) A distribution from a tax-sheltered annuity.
13) A distribution from a qualified employer plan if any part of the distribution is rolled over tax free to another qualified plan or IRA.

The following examples show how to figure the separate tax using the special 10–year averaging method.

Example 1. In 1990, Robert Smith, a calendar-year taxpayer who was born before 1936, retired from Crabtree Corporation. Rather than receive a lifetime pension, Robert withdrew the entire amount to his credit from the plan. In December 1990, he received a total distribution of $70,000 ($12,000 of employee contributions + $58,000 of employer contributions and earnings on all contributions). The payer gave Robert a Form 1099–R, shown on the next page, which shows the ordinary income part of the distribution to be $56,000 and the capital gain part to be $2,000. Robert chooses 20% capital gain treatment for the part attributable to pre-1974 participation. He enters the amount of the capital gain on Form 4972, Part II, line 1, and 20% of the capital gain on Part II, line 2. He enters these figures on Form 4972, as shown on pages 18 and 19.

Box 5, Form 1099–R, shows Robert's contributions of $12,000 to the pension plan. However, he does not enter this on Form 4972. He completes Form 4972 and enters the separate tax of $7,350 on line 39 of his Form 1040.

Example 2. Mary Brown, age 61, sold her business in 1990 and withdrew her entire interest in the profit-sharing plan (a qualified plan) that she had set up as the sole proprietor. The cash part of the amount distributed to Mary is all ordinary income and is shown on her Form 1099–R on page 20.

Mary also received an annuity contract as part of the distribution from the plan. Box 8, Form 1099–R, shows that the current actuarial value of the annuity was $10,000. She enters these figures on Form 4972, as shown on pages 21 and 22.

After completing Form 4972, she enters the separate tax of $3,730 on line 39, Form 1040.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution	OMB No 1545-0119	Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.
Crabtree Corporation Employees' Pension Plan 1111 Broad Street New York, New York 11101	$ 70,000	1990	
	2 Taxable amount $ 58,000	Statement for Recipients of	
PAYER'S Federal identification number: 00-0000000 / RECIPIENT'S identification number: 000-00-0000	3 Amount in Box 2 eligible for capital gain election $ 2,000	4 Federal income tax withheld $ 7,240	
RECIPIENT'S name: Robert C. Smith	5 Employee contributions or insurance premiums $ 12,000	6 Net unrealized appreciation in employer's securities $	Copy B For Recipient
Street address: 911 Mill Way	7 Distribution code: A / IRA/SEP: ☐		This information is being furnished to the Internal Revenue Service.
City, state, and ZIP code: Hometown, New York 11103	8 Other $ %	9 Your percentage of total distribution: 100 %	
Account number (optional)	10 State income tax withheld $	11 State/Payer's state number	

Form 1099-R

Department of the Treasury · Internal Revenue Service

Form **4972**

Department of the Treasury
Internal Revenue Service

Tax on Lump-Sum Distributions

(Use This Form Only for Lump-Sum Distributions From Qualified Retirement Plans)

▶ Attach to Form 1040 or Form 1041. ▶ See separate instructions.

OMB No. 1545-0193

1990

Attachment Sequence No. **28**

Name of recipient of distribution: Robert C. Smith

Identifying number: 000-00-0000

Part I **Complete this part to see if you qualify to use Form 4972.**

			Yes	No
1	Did you roll over any part of the distribution? If "Yes," do not complete the rest of this form	1		X
2	Was the retirement plan participant born before 1936 (and, if deceased, was the participant at least 50 years old at the date of death)? If "No," do not complete the rest of this form	2	X	
3	Was this a lump-sum distribution from a qualified pension, profit-sharing, or stock bonus plan? (See **Distributions That Qualify for the 20% Capital Gain Election or for 5- or 10-Year Averaging** in the Instructions.) If "No," do not complete the rest of this form	3	X	
4	Was the employee a participant in the plan for at least 5 years before the year of the distribution?	4	X	
5	Is this a distribution paid to a beneficiary of an employee who died? If you answered "No" to **4 and 5**, do not complete the rest of this form.	5		X
6	Did you quit, retire, get laid off, or get fired from your job before receiving the distribution?	6	X	
7	Were you self-employed or an owner-employee and became disabled?	7		X
8	Were you age 59½ or older at the time of the distribution? If you answered "No" to **all** questions 5 through 8, do not complete the rest of this form.	8	X	
9	Did you use Form 4972 in a prior year for any distribution received after 1986 from a plan for the same employee (including you) for whom the 1990 distribution was made? If "Yes," do not complete form	9		X

If you qualify to use this form, you may elect to use Part II, Part III, or Part IV; or elect to use Part II and Part III, or Part II and Part IV

Part II **Complete this part to choose the 20% capital gain election.** (See Instructions.)

1	Capital gain part from Box 3 of Form 1099-R (See Instructions.)	1	2,000
2	Multiply line 1 by 20% (.20) and enter here. If you do not elect to use Part III or Part IV, also enter the amount on Form 1040, line 39, or Form 1041, Schedule G, line 1b.	2	400

Part III **Complete this part to choose the 5-year averaging method.** (See Instructions.)

1	Ordinary income from Form 1099-R, Box 2 minus Box 3. If you did not make the Schedule D election or complete Part II, enter the taxable amount from Box 2 of Form 1099-R. (See Instructions.)	1	
2	Death benefit exclusion (See Instructions.)	2	
3	Total taxable amount—Subtract line 2 from line 1	3	
4	Current actuarial value of annuity, if applicable (from Form 1099-R, Box 8)	4	
5	Adjusted total taxable amount—Add lines 3 and 4. If this amount is $70,000 or more, skip lines 6 through 9, and enter this amount on line 10	5	
6	Multiply line 5 by 50% (.50), but **do not** enter more than $10,000	6	
7	Subtract $20,000 from line 5. Enter result. If line 5 is $20,000 or less, enter zero	7	
8	Multiply line 7 by 20% (.20)	8	
9	Minimum distribution allowance—Subtract line 8 from line 6	9	
10	Subtract line 9 from line 5	10	
11	Federal estate tax attributable to lump-sum distribution. Do not deduct on Form 1040 or Form 1041 the amount attributable to the ordinary income entered on line 1 (See Instructions.)	11	
12	Subtract line 11 from line 10	12	
13	Multiply line 12 by 20% (.20)	13	
14	Tax on amount on line 13. See Instructions for Tax Rate Schedule	14	
15	Multiply line 14 by five (5). If no entry on line 4, skip lines 16 through 21. Enter the amount on line 22.	15	
16	Divide line 4 by line 5 and enter the result as a decimal. (See Instructions.)	16	
17	Multiply line 9 by the decimal amount on line 16	17	
18	Subtract line 17 from line 4	18	
19	Multiply line 18 by 20% (.20)	19	
20	Tax on amount on line 19. See Instructions for Tax Rate Schedule	20	
21	Multiply line 20 by five (5)	21	
22	Subtract line 21 from line 15. (Multiple recipients, see Instructions.)	22	
23	Tax on lump-sum distribution—Add Part II, line 2, and Part III, line 22. Enter on Form 1040, line 39, or Form 1041, Schedule G, line 1b ▶	23	

Part IV **Complete this part to choose the 10-year averaging method.** (See Instructions.)

1	Ordinary income part from Form 1099-R, Box 2 minus Box 3. If you did not make the Schedule D election or complete Part II, enter the taxable amount from Box 2 of Form 1099-R. (See Instructions.)			1	56,000
2	Death benefit exclusion. (See Instructions.)			2	-0-
3	Total taxable amount—Subtract line 2 from line 1			3	56,000
4	Current actuarial value of annuity, if applicable (from Form 1099-R, Box 8)			4	-0-
5	Adjusted total taxable amount—Add lines 3 and 4. If this amount is $70,000 or more, skip lines 6 through 9, and enter this amount on line 10			5	56,000
6	Multiply line 5 by 50% (.50), but **do not** enter more than $10,000		6 10,000		
7	Subtract $20,000 from line 5. Enter result. If line 5 is $20,000 or less, enter zero	7 36,000			
8	Multiply line 7 by 20% (.20)		8 7,200		
9	Minimum distribution allowance—Subtract line 8 from line 6			9	2,800
10	Subtract line 9 from line 5			10	53,200
11	Federal estate tax attributable to lump-sum distribution. Do not deduct on Form 1040 or Form 1041 the amount attributable to the ordinary income entered on line 1. (See Instructions.)			11	-0-
12	Subtract line 11 from line 10			12	53,200
13	Multiply line 12 by 10% (10)			13	5,320
14	Tax on amount on line 13. See Instructions for Tax Rate Schedule			14	695
15	Multiply line 14 by ten (10). If no entry on line 4, skip lines 16 through 21. Enter this amount on line 22			15	6,950
16	Divide line 4 by line 5 and enter the result as a decimal. (See Instructions.)			16	
17	Multiply line 9 by the decimal amount on line 16			17	
18	Subtract line 17 from line 4			18	
19	Multiply line 18 by 10% (.10)			19	
20	Tax on amount on line 19. See Instructions for Tax Rate Schedule			20	
21	Multiply line 20 by ten (10)			21	
22	Subtract line 21 from line 15. (Multiple recipients, see Instructions.)			22	6,950
23	Tax on lump-sum distribution—Add Part II, line 2, and Part IV, line 22. Enter on Form 1040, line 39, or Form 1041, Schedule G, line 1b ▶			23	7,350

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution	OMB No. 1545-0119	Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.
Brown's Real Estate Profit-Sharing Plan 2101 Chelsea Court Anytown, California 96503	$ 33,000	1990	
	2 Taxable amount $ 33,000	Statement for Recipients of	
	3 Amount in Box 2 eligible for capital gain election $	4 Federal income tax withheld $ 2.950	
PAYER'S Federal identification number: 00-0000000	RECIPIENT'S identification number: 000 00-0000		
RECIPIENT'S name: Mary Brown	5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	Copy B For Recipient
Street address: 12 Mill Avenue	7 Distribution code: A	IRA/SEP: ☐	This information is being furnished to the Internal Revenue Service.
City, state, and ZIP code: Hometown, California 90302	8 Other Ann.contract $ 10,000 %	9 Your percentage of total distribution: 100 %	
Account number (optional)	10 State income tax withheld $	11 State/Payer's state number	

Form 1099-R — Department of the Treasury Internal Revenue Service

Form **4972**

Department of the Treasury
Internal Revenue Service

Tax on Lump-Sum Distributions

(Use This Form Only for Lump-Sum Distributions From Qualified Retirement Plans)

► Attach to Form 1040 or Form 1041. ► See separate instructions.

OMB No 1545-0193

1990

Attachment Sequence No. **28**

Name of recipient of distribution: Mary Brown

Identifying number: 000-00-0000

Part I Complete this part to see if you qualify to use Form 4972.

			Yes	No
1	Did you roll over any part of the distribution? If "Yes," do not complete the rest of this form	1		X
2	Was the retirement plan participant born before 1936 (and, if deceased, was the participant at least 50 years old at the date of death)? If "No," do not complete the rest of this form	2	X	
3	Was this a lump-sum distribution from a qualified pension, profit-sharing, or stock bonus plan? (See **Distributions That Qualify for the 20% Capital Gain Election or for 5 or 10-Year Averaging** in the Instructions.) If "No," do not complete the rest of this form.	3	X	
4	Was the employee a participant in the plan for at least 5 years before the year of the distribution?	4	X	
5	Is this a distribution paid to a beneficiary of an employee who died? If you answered "No" to 4 **and** 5, do not complete the rest of this form	5		X
6	Did you quit, retire, get laid off, or get fired from your job before receiving the distribution?	6	X	
7	Were you self-employed or an owner-employee and became disabled?	7		X
8	Were you age 59½ or older at the time of the distribution? If you answered "No" to **all** questions 5 through 8, do not complete the rest of this form	8	X	
9	Did you use Form 4972 in a prior year for any distribution received after 1986 from a plan for the same employee (including you) for whom the 1990 distribution was made? If "Yes," do not complete form	9		X

If you qualify to use this form, you may elect to use Part II, Part III, or Part IV; or elect to use Part II and Part III, or Part II and Part IV

Part II Complete this part to choose the 20% capital gain election. (See Instructions.)

1	Capital gain part from Box 3 of Form 1099-R (See Instructions.)	1	
2	Multiply line 1 by 20% (.20) and enter here. If you do not elect to use Part III or Part IV, also enter the amount on Form 1040, line 39, or Form 1041, Schedule G, line 1b.	2	

Part III Complete this part to choose the 5-year averaging method. (See Instructions.)

1	Ordinary income from Form 1099-R, Box 2 minus Box 3. If you did not make the Schedule D election or complete Part II, enter the taxable amount from Box 2 of Form 1099-R. (See Instructions.)			1	
2	Death benefit exclusion (See Instructions.)			2	
3	Total taxable amount—Subtract line 2 from line 1			3	
4	Current actuarial value of annuity, if applicable (from Form 1099-R, Box 8)			4	
5	Adjusted total taxable amount—Add lines 3 and 4 If this amount is $70,000 or more, skip lines 6 through 9, and enter this amount on line 10			5	
6	Multiply line 5 by 50% (.50), but **do not** enter more than $10,000		6		
7	Subtract $20,000 from line 5. Enter result. If line 5 is $20,000 or less, enter zero	7			
8	Multiply line 7 by 20% (.20)		8		
9	Minimum distribution allowance—Subtract line 8 from line 6			9	
10	Subtract line 9 from line 5			10	
11	Federal estate tax attributable to lump-sum distribution Do not deduct on Form 1040 or Form 1041 the amount attributable to the ordinary income entered on line 1 (See Instructions.)			11	
12	Subtract line 11 from line 10			12	
13	Multiply line 12 by 20% (.20)			13	
14	Tax on amount on line 13. See Instructions for Tax Rate Schedule			14	
15	Multiply line 14 by five (5). If no entry on line 4, skip lines 16 through 21 Enter the amount on line 22.			15	
16	Divide line 4 by line 5 and enter the result as a decimal (See Instructions.)			16	
17	Multiply line 9 by the decimal amount on line 16			17	
18	Subtract line 17 from line 4			18	
19	Multiply line 18 by 20% (.20)			19	
20	Tax on amount on line 19 See Instructions for Tax Rate Schedule			20	
21	Multiply line 20 by five (5)			21	
22	Subtract line 21 from line 15 (Multiple recipients, see Instructions.)			22	
23	Tax on lump-sum distribution—Add Part II, line 2, and Part III, line 22 Enter on Form 1040, line 39, or Form 1041, Schedule G, line 1b ►			23	

For Paperwork Reduction Act Notice, see separate instructions.

Form **4972** (1990)

Part IV **Complete this part to choose the 10-year averaging method.** (See Instructions.)

1	Ordinary income part from Form 1099-R, Box 2 minus Box 3. If you did not make the Schedule D election or complete Part II, enter the taxable amount from Box 2 of Form 1099-R. (See Instructions.)	1	33,000
2	Death benefit exclusion. (See Instructions.)	2	-0-
3	Total taxable amount—Subtract line 2 from line 1	3	33,000
4	Current actuarial value of annuity, if applicable (from Form 1099-R, Box 8)	4	10,000
5	Adjusted total taxable amount—Add lines 3 and 4. If this amount is $70,000 or more, skip lines 6 through 9, and enter this amount on line 10	5	43,000
6	Multiply line 5 by 50% (.50), but **do not** enter more than $10,000	6	10,000
7	Subtract $20,000 from line 5. Enter result. If line 5 is $20,000 or less, enter zero (7: 23,000)		
8	Multiply line 7 by 20% (.20)	8	4,600
9	Minimum distribution allowance—Subtract line 8 from line 6	9	5,400
10	Subtract line 9 from line 5	10	37,600
11	Federal estate tax attributable to lump-sum distribution. Do not deduct on Form 1040 or Form 1041 the amount attributable to the ordinary income entered on line 1. (See Instructions.)	11	-0-
12	Subtract line 11 from line 10	12	37,600
13	Multiply line 12 by 10% (.10)	13	3,760
14	Tax on amount on line 13. See Instructions for Tax Rate Schedule	14	469
15	Multiply line 14 by ten (10). If no entry on line 4, skip lines 16 through 21. Enter this amount on line 22.	15	4,690
16	Divide line 4 by line 5 and enter the result as a decimal. (See Instructions.)	16	.2326
17	Multiply line 9 by the decimal amount on line 16	17	1,256
18	Subtract line 17 from line 4	18	8,744
19	Multiply line 18 by 10% (.10)	19	874
20	Tax on amount on line 19. See Instructions for Tax Rate Schedule	20	96
21	Multiply line 20 by ten (10)	21	960
22	Subtract line 21 from line 15. (Multiple recipients, see Instructions.)	22	3,730
23	Tax on lump-sum distribution—Add Part II, line 2, and Part IV, line 22. Enter on Form 1040, line 39, or Form 1041, Schedule G, line 1b ▶	23	3,730

Rollovers

A rollover is a tax-free withdrawal of cash or other assets from one retirement program and its reinvestment in another retirement program. You do not include the amount rolled over in your income, and you cannot take a deduction for it. The amount rolled over is taxable later as the new program pays that amount to you. If you roll over amounts into an IRA, subsequent distributions from the IRA of amounts you rolled over do not qualify for the capital gain or 5- or 10-year averaging treatment discussed earlier.

The most that you can roll over from a qualified total distribution is the fair market value of all the property you received minus any payments you made to your employer's plan (other than your deductible voluntary employee contributions). The most that you can roll over from a partial distribution is the portion of the distribution that would, but for this rollover, be includible in your gross income. Your contributions, other than your deductible voluntary employee contributions, cannot be rolled over. If you roll property over, it must be the same property you received in the distribution, such as stock, or generally the proceeds from the sale of the property. You cannot roll over required minimum distributions, as discussed under *Tax for Not Making Minimum Distributions,* later.

A ***deductible voluntary employee contribution*** is

1) A contribution you made to a qualified employer plan or a government plan that allows these contributions,
2) A contribution that you did not designate as nondeductible, and
3) A contribution that was not mandatory.

The deduction for qualified voluntary employee contributions was repealed for tax years beginning after 1986.

Qualified total distribution. If you receive a distribution from your employer's qualified plan, it will be a qualified total distribution if:

1) It is received within one tax year because your employer ends (terminates) the plan, or
2) It is received within one tax year because your employer completely stops making payments to your profit-sharing or stock bonus plan, or
3) It is a lump-sum distribution, defined earlier, or
4) It is a distribution of deductible voluntary employee contributions.

You must receive a distribution of your complete share in the plan, other than deductible voluntary employee contributions. See *Deductible voluntary employee contributions,* later.

Time for making rollover. You must complete the rollover by the 60th day following the day on which you receive the distribution from your employer's plan. In the case of a series of distributions that may constitute a lump-sum distribution, the 60-day period does not begin to run until the last distribution is made. Also see *Distributions to an alternate payee under divorce or similar proceedings,* later.

Frozen deposits. If an amount that was distributed to you from a qualified employee retirement plan is deposited in an account from which you cannot withdraw it because of either:

1) The bankruptcy or insolvency of any financial institution, or
2) Any requirement imposed by the State in which the institution is located because of the bankruptcy or insolvency (or threat of it) of 1 or more financial institutions in the State,

that amount is considered a "frozen deposit" for the period during which you cannot withdraw it.

A special rule extends the period allowed for a tax-free rollover for frozen deposits. The period during which the amount is a frozen deposit is not counted in the 60-day period allowed for a tax-free rollover to a qualified plan or an IRA. Also, the 60-day period does not end earlier than 10 days after the deposit is no longer a frozen deposit. However, to qualify under this rule, the deposit must be frozen on at least one day during the 60-day rollover period.

Rollover from a qualified plan to an IRA. If your employer ends a qualified pension plan or completely stops making payments to a qualified profit-sharing or stock bonus plan and gives you your complete share in the plan, you may be able to roll over part or all of your share tax free to one or more individual retirement arrangements (IRAs). To qualify, you must receive your complete share in the plan within one tax year (however, see *Partial distributions,* later). It may or may not be a lump-sum distribution, defined earlier. You can receive it in more than one part. For rollovers to your IRA after March 20, 1986, you must make an irrevocable choice by a written notice to the trustee or issuer of your IRA at the time of the rollover that it is a rollover.

To determine whether your distribution was from a qualified plan, check with your employer.

Note: There is a notice requirement. The plan administrator must provide a written explanation of the rules relating to taxation of certain amounts as capital gains, the separate tax on the ordinary income portion of lump-sum distributions, and rollovers. The notice must be provided to the recipient of any qualified total distribution or any partial distribution within two weeks after the distribution is made.

Distributions to an alternate payee under divorce or similar proceedings. If you are an employee's spouse or former spouse (but not a non-spousal beneficiary) and you receive from a qualified employee benefit plan a distribution under a court order in a divorce or similar proceeding, you may be able to roll over all or part of it tax free to an IRA. You can roll over the distribution if:

1) It is the balance to your credit in the plan,
2) It is made under a ***qualified domestic relations order,***
3) You receive it within one tax year (your tax year, not the plan's year),
4) You roll over part or all of it only to an IRA, and
5) In the case of a distribution of property other than money, you roll over the same property you received from the plan.

A ***qualified domestic relations order*** is a judgment, decree, or order relating to payment of child support, alimony, or marital property rights to a spouse, former spouse, child, or other dependent of a participant in the plan.

If you roll over only part of the distribution, the amount you keep must be included in income in the year you receive it. In figuring the taxable amount, however, you are allowed a prorated share of the participant's cost (investment in the contract).

Rollover of a lump-sum distribution. You can roll over tax free part or all of a lump-sum distribution, defined earlier, from your employer's plan. Generally, a lump-sum distribution must include your complete share (other than your deductible voluntary employee contributions and the net earnings on them) in all of your employer's pension plans, profit-sharing plans, or stock bonus plans. However, if you receive your complete share in all your employer's money purchase pension plans within one year and the distribution meets all other requirements, you can roll part or all of it over. This is true even if you do not receive a distribution from your employer's other pension plans that are not money purchase pension plans.

The most you can roll over is the fair market value of the assets that you receive as your share from your employer's plan minus any payments you made to your employer's plan (other than your deductible voluntary employee contributions and the net earnings on them). Also, you must finish the rollover within 60 days after the day you receive the lump-sum distribution.

The possibility that a separated employee's vested benefit may be increased upon reemployment does not prevent a distribution upon separation from service from being rolled over as a lump-sum distribution. However, subsequent distributions after reemployment and increased vesting for benefits accrued before the original separation from service do not qualify for 5- or 10-year averaging or capital gain treatment. The denial of 5- or 10-year averaging and capital gain treatment for subsequent distributions does not apply if the distribution that was rolled over was made without the consent of the participant.

Deductible voluntary employee contributions. If you receive a distribution from your employer's qualified plan of any part of the balance of your accumulated deductible voluntary employee contributions, you can roll over any part of this distribution tax free. The rollover can be either to an IRA or to certain other qualified plans.

Partial rollovers. If you receive your entire share in your employer's plan (other than deductible voluntary employee contributions) either as a lump-sum distribution or because your employer either ends your pension plan or stops making payments to your profit-sharing or stock bonus plan, you can roll over part of the distribution tax free and keep the rest of it.

The amount that you keep must be included in your gross income as ordinary income in the year you receive it. The amount you keep does not qualify for either capital gains treatment or special 5- or 10-year averaging (explained earlier). The amount cannot be deducted from gross income.

Partial distributions. In general, a partial distribution is a distribution (other than a qualified total distribution) to an employee of all or any part of the employee's balance. Accumulated deductible employee contributions are not used in determining the employee's balance.

All or part of the partial distribution can be rolled over tax free to an individual retirement arrangement (IRA) if:

1) The distribution is at least 50% of the employee's balance in the plan,
2) The distribution is made because of the employee's death, disability, or other separation from service, and
3) The employee chooses the tax-free rollover treatment (the choice is irrevocable, if made after March 20, 1986).

For distributions after March 30, 1986, the distribution cannot be one of a series. This requirement does not apply to distributions after December 31, 1986, and before March 31, 1988.

Self-employed individuals are generally treated as employees for the rules on the tax treatment of distributions, including rollover distributions. Also, in the case of a surviving spouse who receives distributions after the employee's death, the rollover rules permit rollovers to an IRA, but not to another qualified plan. For rollovers to your IRA after March 20, 1986, you make the irrevocable choice in item (3) by written notice to the trustee or issuer of your IRA at the time of the rollover. The 50% balance referred to in item (1) does not include any accumulated deductible employee contributions.

If you choose the partial distribution rollover treatment, you cannot later roll over any part of the distribution from the IRA to a qualified plan. Also, no part of a partial distribution is eligible for the special 5- or 10-year averaging or long-term capital gains treatment for any lump-sum distribution (this also applies to any lump-sum distribution you later receive from the same plan or any other plan of the same kind maintained by the same employer). In addition, the special rule that provides that the unrealized appreciation of a lump-sum distribution is not included in gross income until the securities are sold or exchanged will not apply.

Rollover by surviving spouse. You may be entitled to roll over into an IRA (but not into a qualified trust or annuity plan) part or all of the retirement plan distribution you receive as the surviving spouse of a deceased employee. The plan must be qualified and the amount paid to you must be a lump-sum distribution, accumulated deductible voluntary employee contributions, an amount paid to you because the employer ended the plan, or a partial distribution as described in the preceding paragraphs.

Death benefit exclusion. As a surviving spouse, you can, in certain situations, exclude from income up to $5,000 of the distribution as a death benefit exclusion. You cannot roll over into an IRA any part of the distribution that qualifies for this exclusion.

How to treat employee payments. Any contributions by the employee to the employer's qualified plan (other than deductible voluntary employee contributions) cannot be rolled over into an IRA or another qualified plan.

How to report distributions rolled over. On your Form 1040 for the year of the distribution, report the total distribution, excluding any nondeductible contributions you made, on line 17a. On line 17b, report the taxable amount. The taxable amount is the amount on line 17a minus the amount rolled over and minus any allowable death benefit exclusion. If you file form 1040A, report

the total distribution on line 11a and the taxable amount on line 11b.

Other information. For more information on rollovers, including exceptions applicable to Keogh plans, other types of rollovers, and the rollover of proceeds from the sale of property received in a distribution, get Publications 560 and 590.

Note: Retirement bonds purchased under a qualified bond purchase plan can be redeemed even though the owner has not reached age 59½. In addition, the proceeds can be rolled over tax free to an IRA or qualified employer plan. Subsequent distributions, however, do not qualify for the 5– or 10–year averaging or capital gain treatment.

Survivors and Beneficiaries

Generally, pension or annuity income received by a survivor or beneficiary is reported the same as regular pension or annuity income. However, some special rules apply, and they are covered elsewhere in this publication as well as in this section.

Note: See *Distributions to an alternate payee under divorce or similar proceedings*, under *Rollovers*, earlier, for the rules concerning distributions to beneficiaries as a result of divorce or similar proceedings.

Estate tax deduction. If you receive pension or annuity income as the survivor or beneficiary of someone who died, you may be entitled to a deduction for the estate tax that was based on the pension or annuity.

Joint and survivor annuity. If your annuity was a joint and survivor annuity and was included in the decedent's estate, an estate tax may have been paid on the annuity. You, as the surviving annuitant, can deduct ratably over your remaining life expectancy the part of the total estate tax that was based on the annuity provided that the deceased person died after his or her annuity starting date.

There is a special computation that must be made to figure the estate tax deduction for a surviving annuitant under a joint and survivor annuity. See the Income Tax Regulations section 1.691(d)–1.

The estate tax deduction can be taken as an itemized deduction on Schedule A, Form 1040. This deduction is not subject to the 2%-of-adjusted-gross-income floor on miscellaneous deductions.

Survivors of employees. Distributions you get as the beneficiary of a deceased employee may be accrued salary payments, a distribution from employee profit-sharing, pension, annuity, and stock bonus plans, or other items that should be treated separately for tax purposes. The treatment of these distributions depends on what they represent.

Salary or wages paid after the death of the employee are usually the beneficiary's ordinary income. If you are a beneficiary of an employee who died while still employed, and who was covered by any of the retirement plans mentioned, you can exclude from income nonperiodic distributions received that totally relieve the payer from the obligation to pay an annuity. The amount that you can exclude is equal to the deceased employee's contribution to the plan plus any applicable death benefit exclusion.

If you are entitled to receive a survivor annuity on the death of an employee, you must report the annuity under the General Rule (see *Partly Taxable Payments*, earlier) or the Simplified General Rule discussed under *Taxation of Periodic Payments*, earlier. In figuring the excludable amount under any of these rules, add any allowable death benefit exclusion (discussed earlier) to your cost.

The beneficiaries are taxed on interest from an employee's death benefit if all or part of the distributable amount is left on deposit under an agreement to pay interest only.

Survivors of retirees. Benefits paid to you as a survivor under a joint and survivor annuity must be included in your gross income in the same way the retiree would have included them in gross income.

If the retiree had recovered all of the cost of the annuity before death and had been reporting the annuity under the Three-Year Rule, your survivor payments are fully taxable. But if you received the annuity under a joint and survivor annuity as someone other than the survivor, see *Death benefit exclusion*, under *Taxation of Periodic Payments*, and its discussion, *Investment in the Contract (Cost)*, earlier.

If the retiree was reporting the annuity under the General Rule, you should apply the same exclusion percentage to your initial survivor annuity payment called for in the contract. The resulting dollar exclusion will then remain fixed for as long as you receive your survivor annuity. Increases in the survivor annuity made after the original retiree's annuity starting date are fully taxable.

Under the Simplified General Rule, the monthly dollar exclusion figured at the annuity starting date applies to both annuitants under a joint and survivor annuity. Therefore, if the retiree had been reporting the annuity using the Simplified General Rule, you continue to use the same monthly exclusion for your survivor payments.

The death benefit exclusion generally applies only if the employee died while still employed. But it will apply to the survivor of a disability retiree who died before reaching the minimum retirement age. Minimum retirement age generally is the age at which an individual could receive a pension or annuity if that individual is not disabled.

If the death benefit exclusion applies, see *Death benefit exclusion* under *Taxation of Periodic Payments*.

Guaranteed payments. If you are the surviving beneficiary (not a joint and survivor annuitant) and you receive the rest of the distributions guaranteed under a life annuity contract, do not include any amount in your gross income until the distributions you receive, when added to the part of the distributions received by the life annuitant that were excludable from that person's income, equal the cost of the contract. All later distributions are fully taxable. This rule does ***not*** apply if it is possible for you to collect more than the guaranteed amount.

Example. Your husband retired on November 30, 1984, at the age of 60. He received a single-life annuity of $75 per month ($900 per year) starting January 1, 1985. His contributions for the annuity were $3,600. Under the contract, ten years of monthly distributions, a total of $9,000, were guaranteed. If he died before

receiving them, you were to receive the rest of the guaranteed return. He died after 5 years of distributions ($4,500) had been made to him. You will receive the remaining $4,500 of the $9,000 guaranteed in the contract. You will not be taxed until the distributions you receive, when added to the tax-free distributions received by your husband, exceed the cost of the contract. To figure the distributions starting in 1990 that are tax free, you must first find the amounts received tax free by your husband. Figure this as follows:

Husband's investment in contract (cost)	$3,600
Value of refund feature (see Publication 939 for information on how to compute this)	396
Investment in the contract, as adjusted	$3,204
Amounts received by husband	$4,500
Husband's exclusion ratio—$3,204 ÷ $16,380 (annual distribution of $900 × life multiple at 60 of 18.2)	19.6%
Amounts received by husband and not included in income	$ 882

You do not need to include the amounts you receive in gross income until, when added to the $882 received tax free by your husband, they total $3,600, his cost of the contract. Therefore, you can receive $2,718 tax free ($3,600 minus $882). The full $900 you are paid in 1990, 1991, and 1992 ($2,700 in all) is tax free. From the first monthly distribution of $75 you are to receive in 1993, $18 will be tax free. That will use up the total exclusion of $3,600. All amounts you receive from then on will be fully taxable.

Special Additional Taxes

To discourage the use of pension funds for purposes other than normal retirement, the law imposes additional taxes on certain distributions of those funds. Ordinarily, you will not be subject to these taxes if you begin drawing out the funds at a normal retirement age, in reasonable amounts over your life expectancy. The special additional taxes include those on:

- Early distributions.
- Excess distributions.
- Not making minimum distributions.

Each of these taxes is discussed in the following sections. If you must pay any of these taxes, report them on Form 5329, *Return for Additional Taxes Attributable to Qualified Retirement Plans (including IRAs), Annuities, and Modified Endowment Contracts.*

If you meet any of the exceptions to the tax on early distributions, you may have to complete Form 5329 and attach it to your Form 1040 even if you do not owe the tax. See *Who Must File* in the instructions for Form 5329.

Tax on Early Distributions

Most distributions (both periodic and nonperiodic) from qualified retirement plans made to you before you reach age 59½ are subject to an additional tax of 10% on the part of the distribution that you must include in gross income.

For this purpose, a qualified retirement plan means:

1) A qualified employee retirement plan,
2) A qualified annuity plan,
3) A tax-sheltered annuity plan for employees of public schools or tax-exempt organizations, or
4) An individual retirement arrangement (IRA).

Exceptions to tax. The early distribution tax does not apply to distributions that are:

1) Made to a beneficiary or to the estate on or after the death of the participant,
2) Made because you are totally and permanently disabled,
3) Made as part of a series of substantially equal periodic (at least annual) payments over your life expectancy or over the joint life expectancy of you and your beneficiary,
4) Made to you after you separated from service with your employer if the separation occurred during or after the year in which you reached age 55,
5) Paid to you to the extent you have deductible expenses for medical care (whether or not you itemize deductions for the tax year),
6) Paid to alternate payees under qualified domestic relations orders (QDROs), or
7) Made to you if, as of March 1, 1986, you separated from service and began receiving benefits from the qualified plan under a written election designating a specific schedule of benefit payments.

The exception in (3) applies to distributions from non-IRA plans *only* if the payments begin after you separate from service. The exceptions in (4), (5), (6), and (7) do not apply to IRA distributions.

Recapture tax under exception (3). An early distribution recapture tax applies if, before you reach age 59½, the distribution method under exception (3) is changed (for reasons other than your death or disability) from the method requiring equal payments to a method that would not have qualified for the exception to the tax. The recapture tax is imposed for the first tax year in which the change is made. The amount of tax is the amount that would have been imposed had the exception not applied, plus interest for the deferral period.

The recapture tax also applies if you do not receive the payments for at least 5 years under a method that qualifies for the exception, even if the method of distribution is modified after you reach age 59½. In such case, the tax applies only to payments distributed before you reach age 59½.

Tax on early withdrawals from deferred annuity contracts. If you withdraw amounts from your deferred annuity contract before you reach age 59½, you will generally have to pay a 10% penalty tax on the withdrawn amounts. The tax is similar to the tax on early distributions from qualified retirement plans. This is known as the "section 72(q) tax." The tax is 10% of the part of the amount withdrawn that you must include in gross income.

Exceptions to tax. The section 72(q) tax does not apply to distributions that are:

1) Made on or after your death if you are the holder of the annuity contract (or, if the contract is held by an entity other than an individual, on or after your death if you are the primary annuitant),
2) Made because you are totally and permanently disabled,
3) Made as part of a series of substantially equal periodic (at least annual) payments over your life expectancy or the joint life expectancies of you and your beneficiary,
4) Allocable to cost in the contract before August 14, 1982,
5) From an annuity contract under a qualified personal injury settlement,
6) Made under an immediate annuity contract,
7) Made under a contract that is purchased by your employer upon the termination of a qualified employee retirement plan or qualified annuity and that is held by your employer until you separate from the service of the employer, or
8) Subject to the tax on early distributions from qualified plans (discussed earlier), even if they come under any of the exceptions to that tax.

The section 72(q) tax does not apply to early withdrawals from annuity contracts under qualified retirement plans, qualified employee annuity plans, tax-sheltered annuities for employees of public schools or tax-exempt organizations, or individual retirement arrangements (IRAs). ***However,*** the 10% tax on early distributions from qualified retirement plans, discussed earlier, may apply to these withdrawals.

Recapture tax under exception (3). If the distribution method is changed under exception (3) before you reach age 59½, a recapture tax will apply. This recapture tax is figured exactly like the recapture tax on early distributions from qualified retirement plans, discussed earlier.

5% rate on certain early distributions from deferred annuity contracts. If an early withdrawal from a deferred annuity is otherwise subject to the 10% tax, a 5% rate will apply instead if, as of March 1, 1986, you were receiving payments under a written election providing a specific schedule for the distribution of your interest in the contract.

Tax on Excess Distributions

If retirement distributions in excess of $150,000 are made to you during the calendar year, you are subject to a 15% excise tax on the excess. The tax is offset by any 10% early distribution tax that applies to the excess distribution (see the preceding discussion).

Retirement distributions, for this purpose, include distributions from qualified employee retirement plans, qualified annuity plans, tax-sheltered annuities, and individual retirement arrangements (IRAs).

Excluded distributions. The following distributions are excluded from the tax:

1) Distributions after the death of the participant,
2) Distributions to an alternate payee under a qualified domestic relations order (QDRO) if included in the alternate payee's gross income (if so, the distributions are included in determining the alternate payee's excess distributions),
3) Distributions attributable to investment in the contract,
4) Distributions to the extent rolled over tax free,
5) Retirement distributions of annuity contracts, the value of which are not included in gross income at the time of the distribution (other than distributions under, or proceeds from the sale or exchange of, such contracts),
6) Retirement distributions of excess deferrals (and income allocable to them) as discussed under *Fully Taxable Payments*, earlier, and
7) Retirement distributions of excess contributions (and income allocable to them) under section 401(k) plans or IRAs, or excess aggregate contributions (and income on them) under qualified plans.

Combining distributions. If distributions for you are made to you and others, the distributions must be combined in figuring the amount of excess distributions for the year.

Lump-sum distributions. A different limit applies if you choose lump-sum distribution treatment (special averaging or capital gains treatment). In this case the $150,000 annual amount is increased 5 times to $750,000. Then, this increased amount of $750,000 is applied to the lump-sum distribution separately for figuring the separate tax on the lump-sum distribution.

Benefit accruals as of August 1, 1986. If you made a special choice on a return filed for a tax year beginning before 1989, you can use a different rule to figure the excess distributions tax. Under that rule, the part of your distribution that is treated as being from your accrued benefits as of August 1, 1986, is excluded from the amount subject to the tax. To have qualified for this special choice, your accrued benefits on August 1, 1986, must have been more than $562,500.

However, if you made this choice, the computation of the excess distributions tax on your other retirement distributions is affected. For details, see Form 5329 and its instructions.

Increase in estate tax. The federal estate tax on the estate of a decedent dying after 1986 is increased by 15% of the decedent's excess retirement accumulation. This tax cannot be offset by any credits against the estate tax, such as the unified credit. A person's excess retirement accumulation, if any, is the total value (as included in the gross estate) of the decedent's interests in all qualified employee plans, qualified annuity plans, tax-sheltered annuities, individual retirement arrangements, and any other plans that the IRS might include minus the "present value" of a single life annuity for the decedent's life expectancy immediately before death, with annual payments of $150,000.

You figure a decedent's excess retirement accumulation ***without*** regard to:

1) Any community property law,

2) The value of amounts payable to an alternate payee under a QDRO if they are includible in the alternate payee's income,

3) The value of the decedent's cost of the contract, and

4) The excess (if any) of any interests payable immediately ***after*** death over the value of those interests immediately ***before*** death.

Special choice by spouse. If the decedent's spouse is the beneficiary of all the decedent's interests (except for a *de minimis* portion of which persons other than the spouse are beneficiaries) in the plans listed earlier, the spouse can choose not to have the increase in estate tax apply. If the spouse makes this choice, the tax on excess distributions will apply to the spouse on any retirement distributions from the decedent's interests in the retirement plans, as if the interests were the spouse's.

Tax for Not Making Minimum Distributions

To make sure that most of your retirement benefits are paid to you during your lifetime, rather than to your beneficiaries after your death, your retirement payments must generally begin, at the latest, soon after you reach age 70½. The payments cannot be less than the minimum distribution required each year. If the actual distributions to you in any year are less than the minimum required for that year, you (the payee) are subject to an excise tax equal to 50% of the required minimum amount not distributed. This tax is referred to as "tax on excess accumulation" in Part III of Form 5329. The rules on when minimum distributions must begin (required beginning date) and on how they are figured are described below.

This excise tax may be waived if you establish that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall. Also, distributions from plans maintained under union-management agreements put into effect before March 1, 1986, generally will not be subject to the excise tax until plan years beginning after 1990.

Required beginning date. If you reach age 70½ after 1987, qualified employee retirement plans, qualified annuity plans, deferred compensation plans under section 457, and tax-sheltered annuity programs (for benefits accruing after 1985) generally must begin to make distributions to you no later than April 1 of the year following the calendar year in which you reach age 70½. Under this rule, it does not matter whether you are retired. (This rule also applies to individual retirement arrangements (IRAs).)

This rule is effective for distribution years beginning after 1988; that is, for distributions required to be made by April 1, 1990. (If you reached age 70½ during 1988 but had not retired before 1989 and were not a 5% owner, you must generally begin receiving distributions by April 1, 1990.)

Exceptions. The above rule does not apply to governmental plans or church plans. Nor does it apply to you (unless you are a 5% owner) if you reached age 70½ before 1988. Also, a later effective date for the above rule may apply to a plan maintained under a union-management agreement put into effect before March 1, 1986 (but the rule will be effective not later than plan years beginning after 1990).

If one of these exceptions applies to you, you must begin receiving distributions by April 1 of the year following either the calendar year in which you reach age 70½ or the calendar year in which you retire, whichever is later.

Rule for 5% owners. If you are a 5% (or more) owner of the company maintaining the plan, distributions to you must begin by April 1 of the year following the calendar year in which you reach age 70½ regardless of when you retire, even if you reached age 70½ before 1988.

You are considered a 5% owner for this purpose if you were a 5% owner of the company maintaining the plan at any time during the 5-plan-year period ending in the calendar year in which you reach age 70½. If you become a 5% owner during any later plan year, the required beginning date for distributions will be April 1 of the year following the calendar year in which that later plan year ends.

Minimum distributions. You must either:

1) Receive your entire interest in the plan by the required beginning date, as explained above, or

2) Begin receiving periodic distributions by that date in annual amounts calculated to distribute your entire interest over your life expectancy or over the joint life expectancies of you and your designated beneficiary (or over a shorter period).

The term "designated beneficiary" as used here means the individual who is your beneficiary under your retirement plan or annuity upon your death. If you have more than one beneficiary, the beneficiary with the shortest life expectancy, usually the oldest individual, will be the "designated beneficiary" whose age is used to determine the period over which your distributions must be made.

Distributions during employee's lifetime. If your distributions are periodic distributions as listed in (2) above (other than payments under a purchased commercial annuity), a minimum amount must be distributed to you for each year starting with the year in which you reach age 70½ (or retire, if applicable, as explained in the earlier discussion). This year, for simplicity, will be referred to in this discussion as your "70½ year." If you receive periodic distributions, the amount required to be distributed to you by the April 1 following your 70½ year is for your 70½ year. The minimum required distribution for a later year, including the year following your 70½ year, must be made by December 31 of the later year. If no distribution is made in your 70½ year, the minimum required distributions for 2 years will be required to be made in the year after you reach age 70½ (one by April 1 and one by December 31).

Example. You retired in 1989. You reach age 70½ on August 20, 1990. For 1990 (your 70½ year), you must receive a minimum amount from your retirement plan no later than April 1, 1991. You must receive the minimum required distribution for 1991 by December 31, 1991.

Undistributed amounts at your death. If at the time of your death you are receiving periodic distributions as described in (2) above, any payments not made as of the time of your death must be distributed at least as rapidly as under the distribution method being used at the date of your death.

Distributions after the employee's death. If the employee dies on or after the April 1 following his or her 70½ year, and distributions from the retirement plan or annuity before his or her death were being made over either life-expectancy period in (2) above, a minimum amount must be distributed each year for the remaining life expectancy (or the remaining joint life and last survivor expectancy, if applicable). (This rule is necessary to satisfy the requirement stated above that distributions be made at least as rapidly after the employee's death.)

If the employee dies before April 1 following his or her 70½ year, the ***entire account*** must be distributed either:

a) By the December 31 of the fifth year following the year of the employee's death, or

b) In annual amounts over the life or life expectancy of the designated beneficiary.

Which of these two rules applies depends on the terms of the plan (or the policy established by the plan administrator if the plan has not been changed to reflect the new distribution rules). The terms of the plan or the policy of the plan administrator may permit the employee or the beneficiary to choose which of the rules applies. This choice must be made by the earliest date a distribution would be required under any of the rules. Generally, this date is December 31 of the year following the year of the employee's death.

If the employee or the beneficiary did not choose either of the distribution rules in (a) or (b) above and the plan or the plan administrator does not specify the one to apply, distribution must be made under rule (b) if the beneficiary is the surviving spouse and under rule (a) if the beneficiary is someone other than the surviving spouse. Distributions under (b) generally must begin by December 31 of the year following the year of the employee's death. However, if the spouse is the beneficiary, distributions need not begin until December 31 of the year the employee would have reached age 70½, if later.

If a spouse is the designated beneficiary and distributions are to be made under (b) to the spouse after the employee's death, a special rule applies if the spouse dies after the employee but before distributions are required to begin. In this case, distributions may be made to the spouse's beneficiary under either (a) or (b), above, as though the beneficiary were the employee's beneficiary and the employee died on the spouse's date of death. However, if the spouse remarries after the employee's death and the new spouse is designated as the spouse's beneficiary, this special rule applicable to surviving spouses does not apply to the new spouse.

Annuity distributions. Special rules apply if you receive distributions from your retirement plan in the form of an annuity. Your plan administrator should be able to give you information about these rules.

Minimum distributions from an account balance. If there is an account balance to be distributed from your plan (not as an annuity), your plan administrator must figure the minimum amount required to be distributed from the plan each year. For distributions being made over life expectancy, this amount is figured over a period not longer than:

1) The life expectancy of the employee, or the joint life and last survivor expectancy of the employee and the designated beneficiary if distributions begin by the employee's required beginning date, or

2) The life expectancy of the designated beneficiary if the employee dies before the required beginning date.

The plan administrator figures your required minimum distribution for each year by dividing your (or, in the case of distributions after your death, your beneficiary's) account balance by an ***applicable life expectancy*** (from tables published by the IRS). The applicable life expectancy is your remaining life expectancy (or the remaining joint life and last survivor expectancy of you and your designated beneficiary, or the remaining life expectancy of your designated beneficiary, whichever applies).

What types of installments are allowed? The minimum amount required to be distributed for any year may be made in a series of installments (e.g., monthly, quarterly, etc.) as long as the total payments for the year made by the date required are not less than the minimum amount required.

Your plan can distribute more in any year than the minimum amount required for that year, but if it does, you will not receive credit for the additional amount in determining the minimum amount required for future years. However, any amount distributed in your 70½ year will be credited toward the amount required to be distributed by April 1 of the following year.

Life expectancy. For distributions beginning before your death that are made by April 1 after your 70½ year, the initial life expectancy (or joint life and last survivor expectancy) is determined using the ages of you and your designated beneficiary as of your birthdays in your 70½ year.

For distributions after your death (if your death occurs before April 1 following your 70½ year) over the life expectancy of your designated beneficiary, the initial life expectancy of your designated beneficiary is determined using the age of the designated beneficiary as of the beneficiary's birthday in the year distributions must begin.

Unless your plan (or your plan administrator) provides otherwise, your life expectancy (and that of your spouse, if applicable) may be redetermined annually. If life expectancy is not redetermined, the initial life expectancy is simply reduced by one for each year after your 70½ year to determine the remaining life expectancy.

If the life expectancy of the employee or beneficiary (either you or your spouse) is redetermined, and he or she dies, his or her remaining life expectancy is reduced to zero the year following the year of death.

If the life expectancies of both the employee and his or her spouse are redetermined and both of them die,

the entire interest must be distributed by the end of the year following the year of the second death.

Your plan (or your plan administrator) may also permit you and your spouse to choose whether or not your life expectancies are to be redetermined. This choice must be made by the date the first distribution is required to be made from the plan.

Minimum distribution incidental benefit requirement. Beginning in 1989, distributions from a retirement plan during the employee's lifetime must satisfy, in addition to the above requirements, the ***minimum distribution incidental benefit (MDIB) requirement.*** This requirement is to ensure that the plan is used primarily to provide retirement benefits to the employee. After the employee's death, only "incidental" benefits are expected to remain for distribution to the employee's beneficiary (or beneficiaries).

If your spouse is your only beneficiary, the MDIB requirement is satisfied if the general minimum distribution requirements discussed above are satisfied. If your spouse is not your only beneficiary, additional steps must be taken to figure your required minimum distribution. Your plan administrator should be able to figure your required minimum distribution under the MDIB requirement.

Combining multiple annuity accounts for satisfying the minimum distribution requirements. The required minimum distribution must be figured separately for each account. Each qualified employee retirement plan and qualified annuity plan must be considered individually in satisfying its distribution requirements. However, if you have more than one tax-sheltered annuity account or more than one individual retirement arrangement (IRA), you can total the required distributions and then satisfy the requirement by taking distributions from any one (or more) of the tax-sheltered annuities or IRAs, respectively. Distributions from tax-sheltered annuities will not satisfy the distribution requirements for IRAs, nor will distributions from IRAs satisfy the requirements for tax-sheltered annuity distributions.

Worksheet for Simplified General Rule

1. Total pension received this year. Also, enter this amount on Form 1040, line 17a, or Form 1040A, line 11a ..... $_____

2. Your cost in the plan (contract) at annuity starting date, plus any death benefit exclusion* ..... _____

3. | Age at annuity starting date: | Enter: |
   |---|---|
   | 55 and under | 300 |
   | 56–60 | 260 |
   | 61–65 | 240 |
   | 66–70 | 170 |
   | 71 and over | 120 ..... _____ |

4. Divide the amount on line 2 by the number on line 3 ..... _____

5. Multiply the amount on line 4 by the number of months for which this year's payments were made ..... _____

   NOTE: If your annuity starting date is **before 1987,** subtract line 5 from line 1 and enter the result (but not less than zero) on line 9 below. Skip lines 6, 7, 8, 10, and 11.

6. Any amounts previously recovered tax free in years after 1986 ..... _____

7. Subtract the amount on line 6 from the amount on line 2 ..... _____

8. Enter the lesser of the amount on line 5 or the amount on line 7, but no more than the amount on line 1. (If this is zero, your pension is fully taxable.) ..... _____

9. **Taxable pension for year.** Subtract the amount on line 8 from the amount on line 1. Also enter this amount on Form 1040, line 17b, or Form 1040A, line 11b ..... $_____

10. Add the amounts on lines 6 and 8 ..... _____

11. Balance of cost to be recovered. Subtract the amount on line 10 from the amount on line 2 ..... $_____

    NOTE: If your Form W-2P shows a larger taxable amount, use the amount on line 9 instead of the amount from the Form W-2P.

***Statement for death benefit exclusion**

Cost in plan (contract) ..... $_____

Death benefit exclusion ..... _____

Total (enter on line 2 above) ..... $_____

Signed: _____

Date: _____

KEEP FOR YOUR RECORDS

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U.S. GOVERNMENT PRINTING OFFICE : 1990 - 265-609

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